

No. 65113-7-I

**COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON**

GETTY IMAGES (SEATTLE), INC.,
Appellant,

v.

**CITY OF SEATTLE, DIRECTOR OF THE DEPARTMENT OF
EXECUTIVE AFFAIRS, DIVISION OF REVENUE AND
CONSUMER AFFAIRS, and CITY OF SEATTLE, OFFICE OF THE
HEARING EXAMINER,**

Respondent.

Brief of Appellant

Gregg D. Barton, WSBA No. 17022
Stephanie J. Boehl, WSBA No. 39501
PERKINS COIE LLP
1201 Third Avenue, Suite 4800
Seattle, WA 98101-3099
Telephone: 206.359.8000
Facsimile: 206.359.9000

Attorneys for Appellant

FILED
COURT OF APPEALS
STATE OF WASHINGTON
2010 JUL -9 PM 1:49

TABLE OF CONTENTS

	Page
I. Assignment of Error	1
II. Issue Presented	1
III. Statement of the Case	1
A. Procedural History	1
B. Statement of Facts	3
1. Getty Seattle's Business Is to Provide Services Pursuant to a Single Written Contract for a Fixed Fee.	3
2. Getty Seattle Borrowed Funds to Cover Some of Its Costs.	4
3. The B&O Tax Assessment Was Measured by Something Other than Getty Seattle's Gross Income of the Business.	6
IV. Argument	7
A. Pursuant to City Ordinance, Only "Consideration" Received or Entitled to Be Received Is Includable in the Measure of Tax and Getty Seattle's Only Consideration Was \$1 Million Per Annum	8
B. The Funds Transferred to Getty Seattle's Account Were Not "Consideration"	9
C. If Amounts Are Not Consideration, They Are Also Not "Other Emoluments However Designated"	11
D. The Director Cannot Re-Characterize Borrowed Proceeds from the Cash Management System as "Consideration"	13
V. Conclusion	18

TABLE OF AUTHORITIES

	Page
Cases	
<i>Am. Sign & Indicator Corp. v. State</i> , 93 Wn.2d 427, 610 P.2d 353 (1980)	18
<i>Ban-Mac, Inc. v. King Cnty.</i> , 69 Wn.2d 49, 416 P.2d 694 (1966)	16, 17
<i>Comm'r v. Tufts</i> , 461 U.S. 300 (1983)	11
<i>Estep v. King Cnty.</i> , 66 Wn.2d 76, 401 P.2d 332 (1965).....	16, 17
<i>John Sellen Constr. Co. v. Dep't of Revenue</i> , 87 Wn.2d 878, 558 P.2d 1342 (1976)	12
<i>King Cnty. Water Dist. No. 68 v. Tax Comm'</i> , 58 Wn.2d 282, 362 P.2d 244 (1961)	12
<i>Rena-Ware Distrib., Inc. v. State</i> , 77 Wn.2d 514, 463 P.2d 622 (1970)	18
<i>Silverstreak, Inc. v. Dep't of Labor & Indus.</i> , 125 Wn. App. 202, 104 P.3d 699 (2005), <i>aff'd on other grounds</i> , 159 Wn.2d 868 (2007)	12
<i>Simpson Inv. Co. v. Dep't of Revenue (Simpson II)</i> , 141 Wn.2d 139, 3 P.3d 741 (2000)	14, 15
<i>Simpson Investment Company v. Department of Revenue</i> (<i>Simpson I</i>), 92 Wn. App. 905, 962 P.2d 654 (1998), <i>rev'd</i> , 141 Wn.2d 139 (2000).....	6, 13, 15, 16
<i>State v. Reeves</i> , 196 Wash. 145, 82 P.2d 173 (1938)	11
<i>U.S. Tobacco Sales & Mktg. Co. v. Dep't of Revenue</i> , 96 Wn. App. 932, 982 P.2d 652 (1999)	18
<i>Weyerhaeuser Co. v. Dep't of Revenue</i> , 106 Wn.2d 557, 723 P.2d 1141 (1986)	13, 17
<i>Zavatto v. Comm'r</i> , No. 12576-995, 2001 WL 1922716 (T.C. Apr. 24, 2001).....	11

TABLE OF AUTHORITIES
(continued)

	Page
Statutes	
12 U.S.C. § 483	17
RCW 82.04.4281	16
SMC 5.30.035 D.....	passim
SMC 5.30.060 F.....	8
SMC 5.45.050 H.....	8
WAC 458-20-203	18
Other Authorities	
Black's Law Dictionary 19 (9th ed. 2009).....	5, 8, 11
<i>Discharge of Indebtedness, Bankruptcy and Insolvency</i> , 540 Tax Mgmt. Portfolio 3rd (BNA) A-1 (2009).....	11
Martin J. McMahon, Jr., & Daniel L. Simmons, <i>A Field Guide to Cancellation of Debt Income</i> , 63 Tax Law. 415 (2010).....	10
Wash. Dep't of Revenue Final Determination No. 86-309A, 4 WTD 341 (1987)	10, 16
Webster's New World Dictionary.....	8
Webster's Third International Dictionary (unabridged)	8

I. Assignment of Error

The Hearing Examiner and Superior Court erred in determining that borrowed funds are "gross income of the business" under SMC 5.30.035 D for purposes of the City of Seattle business and occupation ("B&O") tax when transferred through a centralized cash management system.

II. Issue Presented

Whether amounts borrowed from affiliates and transferred through a centralized cash management system, are "gross income of the business" under SMC 5.30.035 D.

III. Statement of the Case

A. Procedural History

The Director of the Department of Executive Affairs, Division of Revenue and Consumer Affairs for the City of Seattle ("Director") conducted an audit of Getty Images (Seattle), Inc. ("Getty Seattle") for the period January 1, 2002 through December 31, 2006. CP 284 (Stip. of Fact ¶ 4). The Director issued an assessment, showing an amount due of \$1,603,346. CP 284 (Stip. of Fact ¶ 5). Getty Seattle timely paid the assessment and appealed to the City of Seattle Hearing Examiner's Office. *Id.* The Director later conceded and refunded a small part, leaving the

remaining contested amount of \$1,580,179.20 at issue for which Getty seeks a refund. CP 287 (Stip. of Facts ¶ 21).

The Hearing Examiner affirmed the Director's Assessment, concluding that "amounts transferred into Getty Seattle's account to cover its expenses during the audit period . . . were 'compensation for the rendition of services,' and thus, constitute the 'gross income of the business' SMC 5.30.035 D." CP 58 (Hearing Examiner Decision ¶ 2).

Getty Seattle timely appealed the Hearing Examiner's decision, CP 001, and the Superior Court affirmed on the grounds that "Getty Seattle received consideration for services it provided to Getty affiliates, in the form of amounts transferred into Getty Seattle's accounts." CP 535. The court justified its holding by concluding that borrowed funds may be included as gross income under the ordinance because SMC 5.30.035 D defines "gross income of the business" to include "other emoluments however designated." *Id.*

Thereafter, Getty Seattle filed a motion for reconsideration, which was denied on March 16, 2010, CP 564, and Getty Seattle timely filed its notice of appeal on March 22, 2010.¹

¹ The Superior Court denied Getty Seattle's motion for reconsideration, noting in her order that she did not consider Getty Seattle's timely filed reply. *Id.*

B. Statement of Facts

Getty Seattle is one of a number of affiliated companies, referred to here as the "Getty Affiliated Group." *Id.* The Getty Affiliated Group is in the business of providing stock photographs, footage, and editorial images internationally and has offices in more than 25 countries. CP 284-85, 351.

1. Getty Seattle's Business Is to Provide Services Pursuant to a Single Written Contract for a Fixed Fee. Getty Seattle does not license imagery to third parties; rather, its business is to provide management and administrative services to the Getty Affiliated Group. It accomplishes this pursuant to a contract with an affiliate, Getty Images (Management Company) LLC ("Getty Management") to provide such services for an annual fee. CP 284-85 (Stip. of Fact ¶ 12), 74-78. The "General and Administrative Services Agreement" provides that "In consideration for the Costs of the Services performed by [Getty Seattle] ... [Getty Management] shall pay [Getty Seattle] an amount equal to one million dollars per annum." CP 75 (par. 5.1). B&O tax was properly paid on such consideration. CP 285 (Stip. of Fact ¶ 9). There were no other agreements and no intention that Getty Seattle be entitled to any other consideration. CP 352. Furthermore, there is no evidence that each of the

separate members of the Getty Affiliated Group, and their relationships with one another, were not respected within and without the group.

2. Getty Seattle Borrowed Funds to Cover Some of Its

Costs. The Getty Affiliated Group operates a cash management system. CP 353-57, 412-14. Getty Seattle used amounts transferred by way of the cash management system (or "swept") to pay expenses incurred during the audit period. CP 286 (Stip. of Fact ¶ 16), 381. Under the cash management system (acknowledged by the Director as "typical" (CP 414)), the funds of affiliate entities are swept together to a concentration account on a nightly basis. CP 353-54, 381. As a result, each affiliate's respective bank account is reduced to a zero balance at the end of every day. *Id.* The following day, funds are transferred back to affiliate entities to satisfy bills and expenses. CP 354.

Cash management systems are common among companies with multiple legal entities and serve as a means to efficiently utilize a company's cash for both investment purposes and payment of expenses. CP 36-37. The centralized account receives a higher interest rate than would be available to each smaller, individual account. CP 354-55. In addition, a centralized account allows cash to be more easily used. CP 355.

The sweeping and transfer of cash, under a typical cash management system, represents intercompany borrowing and lending between affiliate entities. CP 355-56. The Director's auditor (CP 412-13), confirmed that an affiliate that receives cash accounts for an increase in its intercompany account payables to the affiliate whose cash was swept pursuant to generally accepted accounting principles ("GAAP"). CP 355-56.² An intercompany account payable is a liability and reflects a debt owed by one affiliate to another. CP 356, 411. Likewise, an affiliate whose cash is swept accounts for an increase in its account receivables due from the affiliate who received the cash. CP 355-56.³ An intercompany account receivable is an asset and reflects an amount owed from one affiliate to another. CP 356, 411.

Recognizing the existence of this obligation to repay, the Director admitted that "if Getty Management were sold, the sales price received by Getty Seattle would include the value of the accounts receivable." CP 547.

As is the common practice with companies operating a cash management system, the Getty Affiliated Group did not execute loan documents reflecting these intercompany payables and receivables.

² An "account payable" is defined as "[a]n account reflecting a balance owed to a creditor. . . ." Black's Law Dictionary 19 (9th ed. 2009).

³ An "account receivable" is defined as "[a]n account reflecting a balance owed by a debtor. . . ." Black's Law Dictionary 19 (9th ed. 2009).

CP 357. Despite the lack of a formal loan contract, the transfer and receipt of cash represent debts owed to or from respective affiliates. *Id.* This point was conceded by the Director's witness who acknowledged that cash management transfers represent debt, and that debt proceeds (whether received from a bank or affiliate) are not gross income. CP 411, 415.⁴

Finally, the common usage of cash management systems by affiliated groups in Washington is thoroughly documented. For example, both the taxpayer and Department of Revenue in the briefs filed in *Simpson Investment Company v. Department of Revenue (Simpson I)*, 92 Wn. App. 905, 962 P.2d 654 (1998), *rev'd*, 141 Wn.2d 139 (2000) (reversing court of appeals on issue whether Simpson was a "financial business") recite facts regarding cash management systems that mirror those in this case. *See* Appellant's Opening Brief 14-15, 40-42 (attached as Appendix A); Brief of Respondent 5-7 (Appendix B); Appellant's Reply Brief 15-18 (Appendix C); Answer to Petition for Review 4-6 (Appendix D).

3. The B&O Tax Assessment Was Measured by

Something Other than Getty Seattle's Gross Income of the Business.

The contested portion of the B&O tax assessment was measured by \$307

⁴ CP 415 ("Q. And if Getty Seattle could have borrowed funds from a bank and gotten proceeds tax free, as you testified earlier, can you tell me why it could not borrow from its own affiliates? [Director's Springer] A. I would assume it -- it could borrow from its own affiliates, yes.")

million in fees earned by Getty Management, not Getty Seattle, and recorded as income in Getty Management's books and records. CP 287 (Stip. of Fact ¶ 20), 56 (Hearing Examiner's Decision ¶¶ 11, 15 (Findings of Fact)). Despite the fact that the Director measured Getty Seattle's B&O tax liability by the income earned and received by a separate entity in the amount of \$307 million, both the Hearing Examiner and Superior Court affirmed the assessment on the grounds that "[cash management] amounts transferred into Getty Seattle's account" were properly included as "gross income of the business either because it was 'compensation' or 'other emoluments however designated.'" CP 58, 535. However, the amounts transferred by way of the cash management system into Getty Seattle's account from Getty Management with whom it contracted to provide the services, was not \$307 million but only \$82 million. CP 358.

IV. Argument

Getty Seattle was assessed and improperly required to pay approximately \$1.6 million in Seattle B&O tax because a portion of its expenses were paid with borrowed funds from affiliated entities by way of the Getty Affiliated Group's centralized cash management system. As a fundamental principle of taxation, borrowed funds are excluded from gross income because the obligation to repay such funds offsets any economic benefit. This is also the result dictated by a plain reading of the

City of Seattle ordinances. Getty Seattle is entitled to a refund for taxes paid on funds borrowed from affiliate entities.

A. Pursuant to City Ordinance, Only "Consideration" Received or Entitled to Be Received Is Includable in the Measure of Tax and Getty Seattle's Only Consideration Was \$1 Million Per Annum

Getty Seattle pays B&O tax as a service business on its "gross income of the business." SMC 5.45.050 H. The City ordinance defines "gross income of the business," in pertinent part, as:

the value proceeding or accruing . . . and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends and other emoluments however designated. . . .

SMC 5.30.035 D (emphasis added). "Value proceeding or accruing" is defined as "*consideration . . . a person is entitled to receive or accrue or which is actually received or accrued.*" SMC 5.30.060 F (emphasis added).

The Hearing Examiner defined "consideration" to mean:

"a recompense, as for a service rendered; fee; compensation," Webster's New World Dictionary (emphasis added), "something given as a recompense," Webster's Third International Dictionary (unabridged), or something 'bargained for and received by a promisor from the promise; that which motivates a person to do something, esp. to engage in a legal act.' Black's Law Dictionary (emphasis added).

CP 57-58.

In this case, the evidence is uncontested that Getty Seattle and Getty Management determined by written agreement that the "*consideration* for the Costs of the Services performed by [Getty Seattle] ... [is] one million dollars per annum." CP 75 (General and Administrative Services Agreement ¶ 5.1 (emphasis added)). Pursuant to the agreement, Getty Seattle received \$ 1 million in compensation for its services and paid B&O tax on that compensation. CP 285 (Stip. of Fact ¶ 9). Having entered into one agreement for the provision of services, surely had the parties intended for other services to be compensated differently they would have entered into additional service agreements. Likewise, had the parties intended that Getty Seattle be compensated more than the amount set forth in the Agreement, then surely they would have either amended it or provided for additional compensation in other agreements. There were no other agreements and no intention Getty Seattle be entitled to any additional consideration. CP 105, 352, 405.

B. The Funds Transferred to Getty Seattle's Account Were Not "Consideration"

The Hearing Examiner and Superior Court Judge's conclusion that "amounts transferred into Getty Seattle's account" were properly included as "gross income of the business," either because they were "compensation" or "other emoluments however designated," is inconsistent with the facts and ordinances. The Washington State

Department of Revenue has consistently determined that amounts transferred pursuant to cash management systems are not "gross income of the business." Wash. Dep't of Revenue Final Determination No. 86-309A, 4 WTD 341, 347 (1987) (attached as Appendix E) (a cash management system does not result in taxable income because "the money management techniques *do not result in any actual payments or receipts to the taxpayer*" (emphasis added); *see also* CP 166 (Wash. Dep't of Revenue written explanation summarizing the tax results of cash management systems and concluding that systems with daily transactions characterized with the features of loans "do not constitute a taxable activity").

Those funds transferred to the Getty Seattle account and found to be gross income of the business by the Hearing Examiner and Superior Court Judge were advances under the Getty Affiliated Group's cash management system that resulted in payables due from Getty Seattle to the other affiliates. Consequently, they are intercompany debts-- not consideration.

"As a fundamental principle of tax, borrowed funds are excluded from gross income because the obligation to repay borrowed funds offsets the economic increment even though borrowed funds increase a taxpayer's assets and can be used as the taxpayer sees fit." Martin J. McMahon, Jr., & Daniel L. Simmons, *A Field Guide to Cancellation of Debt Income*,

63 Tax Law. 415, 417 (2010); *see also Comm'r v. Tufts*, 461 U.S. 300, 307 (1983) ("When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. Because of this obligation, the loan proceeds do not qualify as income to the taxpayer."); *Zavatto v. Comm'r*, No. 12576-995, 2001 WL 1922716, at *2 (T.C. Apr. 24, 2001) ("Generally, loan proceeds are not income to the borrower."); *Discharge of Indebtedness, Bankruptcy and Insolvency*, 540 Tax Mgmt. Portfolio 3rd (BNA) A-1 (2009) ("The mere borrowing of money does not result in taxable income to the borrower, because the receipt of borrowed money is offset by the obligation to repay.").

C. If Amounts Are Not Consideration, They Are Also Not "Other Emoluments However Designated"

"Emoluments" is an unusual term, but the Director and Hearing Examiner each acknowledged that it merely means *compensation or consideration*. CP 57-58 (Hearing Examiner's Findings of Fact, "emolument" means compensation (citing Black's Law Dictionary)), 423 (testimony of Director's Springer acknowledging "emolument is equivalent to the word consideration"); *see also State v. Reeves*, 196 Wash. 145, 148, 82 P.2d 173 (1938) ("The word 'emolument' is defined in Webster's dictionary as 'profit from office, employment, or labor; compensation; fees or salary.'"). Therefore, amounts subject to tax

because of the phrase “other emoluments however designated” are limited to examples of compensation, which necessarily excludes borrowed funds.

Furthermore, under the rule of ejusdem generis, the phrase "other emoluments however designated" must be read in conjunction with the preceding specific terms provided. "When faced with general terms in a sequence with specific terms, the rule of ejusdem generis states that the general term is restricted to items similar to the specific terms."

Silverstreak, Inc. v. Dep't of Labor & Indus., 125 Wn. App. 202, 211, 104 P.3d 699 (2005), *aff'd on other grounds*, 159 Wn.2d 868 (2007); *see also John Sellen Constr. Co. v. Dep't of Revenue*, 87 Wn.2d 878, 883-84, 558 P.2d 1342 (1976) ("General terms appearing in a statute in connection with precise, specific terms, shall be accorded meaning and effect only to the extent that the general terms suggest items or things similar to those designated by the precise or specific terms. In other words, the precise terms modify, influence or restrict the interpretation or application of the general terms where both are used in sequence or collocation in legislative enactments.") (internal quotation marks and citation omitted). It is a well-established rule of statutory construction, where there are specific words used followed by general words, the specific words govern the character or kind of the matter included in the general words. *King Cnty. Water Dist. No. 68 v. Tax Comm'*, 58 Wn.2d 282, 286, 362 P.2d 244 (1961) (In

determining the scope of the phrase "gross operating revenue," the "phrase 'including operations incidental thereto' is governed by the specific [preceding] words 'performance of the * * * business. . .'" (citations omitted). In other words, "other emoluments" is not given its broadest possible meaning, but is restricted to the same class or nature as the other terms provided. Therefore, compensation taxable under this designation must necessarily represent income, and additionally, be analogous to "commissions," "rents," "royalties," etc. As established above, debt is not income because it represents an ongoing obligation, and as such, it is not similar to commissions, rents, and royalties because it must be repaid.

Finally, "[a]ny doubts as to the meaning of a statute under which a tax is sought to be imposed will be 'construed against the taxing power.'" *Weyerhaeuser Co. v. Dep't of Revenue*, 106 Wn.2d 557, 566, 723 P.2d 1141 (1986) (citations omitted). Therefore, this Court's interpretation of SMC 5.30.035 D must furthermore be construed against the Director.

D. The Director Cannot Re-Characterize Borrowed Proceeds from the Cash Management System as "Consideration"

Lastly, attempts to re-characterize the funds transferred as consideration is inconsistent with court precedent. For example, in *Simpson I*, 92 Wn. App. 905, the court rejected the Washington State Department of Revenue's argument that interest earned on Simpson's cash management system should be re-characterized as consideration for

services performed, or "fee income," even though Simpson did not charge its affiliates for administrative services performed on their behalf.

Simpson, like Getty Seattle, was a member of an affiliated organization and performed administrative services for its affiliates free of charge. *Simpson Inv. Co. v. Dep't of Revenue (Simpson II)*, 141 Wn.2d 139, 143-44, 3 P.3d 741 (2000). At issue was whether interest earned on the company's cash management system was taxable. Interest is generally deductible unless a company is found to be a financial business. The Washington State Department of Revenue argued that Simpson owed tax on interest earned because Simpson was a financial business *and* because the interest represented fee income for administrative services provided at no charge.

The Department of Revenue asserted that even if Simpson was not a financial business, it nevertheless "would still be ineligible to take the deduction for interest earned on its investment of its subsidiaries surplus funds pursuant to its cash management system because it would be *fee income* to Simpson." Brief of Respondent 11 (emphasis added) (Appendix B attached hereto). The Department further claimed:

[T]he interest earned on Simpson's overnight investment of its subsidiaries' surplus funds pursuant to its cash management activities is not investment income to Simpson. The interest received by Simpson from investing its subsidiaries funds, and erroneously reported by Simpson

as interest income, *is really . . . compensation for services* (finance and accounting, credit, human resources, legal, management information services, public affairs, risk, tax and treasury) *Simpson provides to its subsidiaries for which it does not charge* and [consequently] Simpson is reporting under the wrong B&O tax classification and owes substantial additional tax.

Brief of Respondent 13-14 (Appendix B attached hereto).

The court of appeals expressly rejected this argument, stating "Simpson did not charge the companies or their subsidiaries for its services" and "nothing prevents Simpson from avoiding B&O tax . . . for services provided." *Simpson I*, 92 Wn. App. at 910, 917 n.14.

Even though the Washington Supreme Court overruled the court of appeals, holding that Simpson was a financial business, the court's analysis confirmed that proceeds received from a cash management system may not be re-characterized as payment for services. The court concluded that Simpson's receipt of interest from its cash management system should be reported as interest and not as compensation for services rendered under the service and other B&O classification. *Simpson II*, 141 Wn.2d at 163. Accordingly, the court explained, "[a]ll of Simpson's income comes from financial sources." *Id.* Additionally, the court noted, "Simpson provides services, but these services are simply a means of increasing the value of its initial investment, *not an independent source of income.*" *Id.* at 154 (emphasis added). If the funds had been re-

characterized, Simpson would have failed the court's test for a financial business. More important though, taxpayers before and certainly after, have understood and relied on the conclusion that they are not required to charge for intercompany services and are not required to pay B&O tax for such services, unless they in fact charge for them. *See Simpson I*, 92 Wn. App. at 917 n.14; *see also*, Wash. Dep't of Revenue Final Determination No. 86-309A, 4 WTD 341, 347 (1987) (attached as Appendix E) (a cash management system does not result in taxable income because "the money management techniques *do not result in any actual payments or receipts to the taxpayer*" (emphasis added); CP 166 (Wash. Dep't of Revenue written explanation summarizing the tax results of cash management systems and concluding that systems with daily transactions characterized with the features of loans "do not constitute a taxable activity"). Accordingly, Washington tax laws do not require payments for services, and in their absence, they are not imputed from transfers pursuant to a cash management system.⁵

Second, Getty Seattle is permitted to structure intercompany transactions in such a manner so as not to increase its taxes. *Estep v. King Cnty.*, 66 Wn.2d 76, 77, 401 P.2d 332 (1965). In *Ban-Mac, Inc. v. King*

⁵ In that case, Simpson received dividends that are deductible under RCW 82.04.4281, but that does not change the court's conclusion that unless there are express charges for the service, the tax is avoided – whether there is no cash transfer, or one by dividend or borrowed funds.

Cnty., 69 Wn.2d 49, 50-51, 416 P.2d 694 (1966), the Washington Supreme Court explained that even if a transaction is structured to minimize tax that is "not justification for legislation by the judiciary . . . [w]e may construe but not legislate in tax matters."

Third, Getty Seattle's tax result is controlled by the express contract between the parties, which limits consideration to \$1 million per annum. See *Weyerhaeuser*, 106 Wn.2d at 557, 563, 566; *Ban-Mac*, 69 Wn.2d 49; *Estep*, 66 Wn.2d 76. At issue in *Weyerhaeuser* was whether installment sales contracts, which did not include interest for payments over time, could be re-characterized as having an interest component (or whether interest could be "imputed"). 106 Wn.2d at 565. The federal tax system statutorily permitted re-characterization to reflect the economic substance. *Id.* at 566 (12 U.S.C. § 483). However, the Washington Supreme Court rejected the Department of Revenue's arguments to re-characterize the income absent specific statutory authority.

We hold that, where an installment contract for the sale of timber does not provide for interest, the Department of Revenue may not impute such interest without specific statutory or regulatory authority.

In reaching our holding we are not unmindful that certain taxpayers may attempt to circumvent higher taxation rates by simply refusing to specify interest on their installment contracts. Such circumvention of the tax laws may be addressed by statute.

Id.

Fourth, Washington's courts and the Department of Revenue have long recognized that the tax liability of separately organized entities must be determined without regard to their relationship to affiliate entities. *Am. Sign & Indicator Corp. v. State*, 93 Wn.2d 427, 429, 610 P.2d 353 (1980) (citing WAC 458-20-203; and *Rena-Ware Distrib., Inc. v. State*, 77 Wn.2d 514, 463 P.2d 622 (1970)). As a result, affiliates are taxed on intercompany transactions to the extent of any consideration.

Consistent with the taxation of transactions between affiliates, Washington law does not permit the Director to disregard the separate identities of affiliated entities and treat them as one for tax purposes. *U.S. Tobacco Sales & Mktg. Co. v. Dep't of Revenue*, 96 Wn. App. 932, 943, 982 P.2d 652 (1999). Accordingly, the Director conceded in this case that it must respect both entities as separate entities. CP 403 (testimony of Director's Springer), 102 (deposition of Springer), 184 (deposition of Director's Cunha).⁶

V. Conclusion

For the reasons stated herein, the Superior Court's holding affirming the Hearing Examiner's decision is contrary to the facts and law and should be reversed. Getty Seattle is entitled to a refund of B&O taxes

⁶ Of course this it must do. If all the affiliates are treated as one, there is no transaction to tax and Getty Seattle is entitled to its refund.

paid on amounts borrowed from affiliates by way of the company's cash management system. Funds transferred under a cash management system are debt to the receiving affiliate entity. Debt is not consideration to the borrower. Therefore, borrowed funds under a cash management system are not "gross income of the business" under SMC 5.30.035 D and are not subject to B&O tax.

DATED: July 9, 2010

PERKINS COIE LLP

By: 

Gregg D. Barton, WSBA No. 17022

GBarton@perkinscoie.com

Stephanie J. Boehl, WSBA No.

39501

SBoehl@perkinscoie.com

1201 Third Avenue, Suite 4800

Seattle, WA 98101-3099

Telephone: 206.359.8000

Facsimile: 206.359.9000

Attorneys for Appellant

APPENDIX A

67630-5

~~No. 65394-1~~

SUPREME COURT
OF THE STATE OF WASHINGTON

SIMPSON INVESTMENT COMPANY

Plaintiff/Appellant

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Defendant/Respondent

Appeal From Thurston County Superior Court
Honorable Christine A. Pomeroy

APPELLANT'S OPENING BRIEF

George C. Mastrodonato
WSBA No. 07483
Michael B. King
WSBA No. 14405
Kathleen D. Benedict
WSBA No. 07763
LANE POWELL SPEARS LUBERSKY LLP
Attorneys For Appellant
SIMPSON INVESTMENT COMPANY

BY C. J. HERRITS

97 OCT -7 11:11:00

RECEIVED
SUPREME COURT
STATE OF WASHINGTON

Lane Powell Spears Lubersky LLP
711 Capitol Way South
Olympia, Washington 98501-1231
Telephone: (360) 754-6001
Facsimile: (360) 754-1605

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES	iv
ASSIGNMENTS OF ERROR	1
STATEMENT OF ISSUES	1
I. INTRODUCTION	2
II. STATEMENT OF THE CASE	4
A. Procedural History of the Case	4
B. Overview of Simpson Investment Company	6
1. Accounting/Finance	7
2. Credit	8
3. Human Resources	8
4. Legal	9
5. Management Information Services	9
6. Public Affairs	9
7. Risk Management	10
8. Tax	10
9. Treasury	10
10. Cash Management	10
11. Property Management/Real Estate	11

- C. Overview Of Simpson's Subsidiaries 11
 - 1. Simpson Timber Company 11
 - 2. Simpson Paper Company 12
 - 3. Simpson Extruded Plastics Company 12
 - 4. Simpson Foreign Sales Company 13
- D. Simpson's Investment Income 13
 - 1. Interest on Savings and Bank Deposits 14
 - 2. Dividends From Stock in Competitor Companies 16
 - 3. Market Hedging and Futures Trading 16
- III. STANDARD OF REVIEW 18
- IV. ARGUMENT 18
 - A. Simpson Is Entitled to the Benefits of the Section 4281 Deduction Because Simpson Is Not a "Financial Business," as That Term Has Been Defined and Applied by the Legislature and by This Court -- and, Until Recently, by the Department 18
 - B. A Holding Company Generally Is Not Treated as a "Financial Business," Unless Financial Business Is Specifically Defined to Include Holding Companies. Nothing in the Language or History of Section 4281 Supports a Departure From These Well Established Principles of Business Law and Practice 33

C. The Department Erroneously Denied Simpson
the Section 4281 Deduction Based on Simpson's
Cash Management System 40

D. The Department's Recent Determinations
Regarding the Section 4281 Deduction Are
Inconsistent With Legislative Intent and This
Court's Decisions, and Also Constitute Improper
Rule-Making Under the APA 42

V. CONCLUSION 51

TABLE OF AUTHORITIES

Page

CASES

<u>Ashenbrenner v. Department of Labor and Industries</u> , 62 Wn.2d 22, 26, 380 P.2d 730 (1963)	23
<u>Dawson v. Daly</u> , 120 Wn.2d 782, 845 P.2d 995 (1993)	21
<u>Failor's Pharmacy v Department of Social and Health Services</u> , 125 Wn.2d 488, 886 P.2d 147 (1994)	51
<u>International Thomson Business Information, Inc. v. Director, Division of Tax</u> , 14 N.J. Tax 424 (N.J. Tax Ct. 1995)	37, 38, 39
<u>John H. Sellen Construction Company v. Department of Revenue</u> , 87 Wn.2d 878, 558 P.2d 1342 (1976)	1, 3, 4, 21, 24, 25, 26, 27, 28, 29, 30, 31, 36, 42, 44, 45, 47, 49
<u>Marble Mortgage Co. v. Franchise Tax Board</u> , 241 Cal. App. 2d 26, 50 Cal. Rptr. 345 (Cal. App. 1966)	35, 36
<u>North American Co. v. Securities & Exchange Commission</u> , 327 U.S. 686, 90 L. Ed. 945, 66 S. Ct. 785 (1946)	34

<u>Rainier Bancorporation v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982)</u>	2, 3, 4, 29, 30, 31, 33, 44, 46, 47, 49
<u>State v. Akin, 77 Wn. App. 575, 892 P.2d 774 (1995)</u>	22
<u>State v. Hennings, 129 Wn.2d 512, 919 P.2d 580 (1996)</u>	21
<u>Timberline Air Service, Inc. v. Bell Helicopter-Textron, Inc., 125 Wn.2d 305, 884 P.2d 920 (1994)</u>	18
<u>United States Steel Corporation v. Gerosa, 7 N.Y.2d 454, 199 N.Y.S.2d 425, 166 N.E.2d 489 (1960)</u>	39

STATUTES

12 U.S.C. § 548(b)	36
12 U.S.C. § 1844	30, 32
RCW ch. 34.05	2, 50
RCW 34.05.230(1)	51
RCW 82.04.030	19
RCW 82.04.055(2)(f)	22, 40
RCW 82.04.220	18
RCW 82.04.290	21, 22, 27
RCW 82.04.340(1)	21

RCW 82.04.430	21
RCW 82.04.4281	passim
RCW ch. 82.32	50
Laws of 1935, ch. 180 § 12	21
1970 1st Ex. Sess. ch. 101, § 2	21
Laws of 1980, ch. 37 § 2	21
Laws of 1993, 1st Spec. Sess., ch. 25	21, 22, 23
California Bank and Corporation Franchise Tax Act, Rev. & Tax. Code, § 23183 <u>et seq.</u>	35
I.R.C. § 922	13

MISCELLANEOUS

2 A. Dewing, <u>The Financial Policy of Corporations, Chapter 6, The Holding Company</u> (4th ed. 1941)	34
<u>Fletcher Cyclopedia of Corporations</u> , § 2821 (perm. ed. 1997)	34
R. Spector, <u>Family Trees: Simpson's Centennial Story</u> , (1990)	6
<u>Webster's Third International Dictionary</u> (1968)	25
<u>Wall Street Journal</u> , Tues., Sept. 16, 1997	41
ETB 505.04.109, 2 ETB 309	28, 29, 36, 42
ETB 571.04.146/109	48, 49, 50, 51

2 WTD 83 (1986) 43
4 WTD 341 (1987) 43, 44, 45, 46, 49
6 WTD 89 (1988) 46, 47
14 WTD 269 (1995) 47, 48, 49

ASSIGNMENTS OF ERROR

1. The Thurston County Superior Court erred in denying Simpson Investment Company's Motion for Summary Judgment and ordering the entry of a judgment dismissing Simpson Investment Company's refund claim with prejudice. (CP 292.)

2. The Thurston County Superior Court erred in holding that Simpson Investment Company is a "financial business" for purposes of RCW 82.04.4281, and therefore precluded from deducting the measure of business and occupation tax interest income earned on the deposit of its subsidiaries' funds, dividends on stock held in its competitors in the timber and forest products industry, futures trading income from wood products market hedging, and minor amounts of interest earned from notes and contracts. (CP 292.)

STATEMENT OF ISSUES

The following issues pertain to all of the Assignments of Error:

1. Whether the Department of Revenue's claim, that the maintenance of a cash management system by the parent company of nonfinancial businesses renders the parent a financial business under RCW 82.04.4281, should be upheld when that claim is not supported by the statutory language or this Court's decisions in John H. Sellen Construction

Company v. Department of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976), and Rainier Bancorporation v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982), construing that language.

2. Whether the Department of Revenue's position, that holding companies which invest amounts derived from their nonfinancial business subsidiaries through cash management systems are financial businesses even though such holding companies are primarily involved in providing administrative services for those subsidiaries, can fairly be reconciled with the language of RCW 82.04.4281 which does not define a holding company to be a financial business.

3. Whether the Department of Revenue's interpretations of RCW 82.04.4281, and the applicability of the deduction for investment income thereunder, are invalid because they were not adopted as rules as required by the Administrative Procedure Act, Chapter 34.05 RCW.

I.

INTRODUCTION

The issue before this Court involves the interpretation and application of the Washington business and occupation ("B&O") tax deduction statute, RCW 82.04.4281 (formerly 82.04.430(1)) ("the Section 4281 deduction"). This provision allows a deduction "from the measure

of tax amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such, and also amounts derived as dividends by a parent from its subsidiary corporations." The Section 4281 deduction has been twice reviewed by this Court, and held to apply to the investment income of businesses not engaged in a financial business. John H. Sellen Construction Company v. Department of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976) ("Sellen"); Rainier Bancorporation v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982) ("Rainier"). This Court's determinations in Sellen and Rainier thus provide the parameters for determining whether a business is a "financial business" for purposes of the Section 4281 deduction.

The Department of Revenue recently adopted an interpretation of the Section 4281 deduction, obviously designed to narrow the deduction's applicability. The Department has done this through a series of determinations and tax bulletins, which presume to impose an interpretation of "financial business" using eligibility tests not supported by the language of the deduction, nor by the rationale or holdings of this Court's decisions in Sellen and Rainier. The Department has imposed these tests even though the Legislature recently amended the Section 4281

deduction and other sections of the B&O tax to limit the definition of financial business to traditional moneyed businesses. The Department's interpretation of financial business thus is contrary to this Court's determinations in Sellen and Rainier, and the deduction's legislative history -- as well as the Department's prior interpretation of the term, under earlier determinations and tax bulletins.

Any broadening of the term "financial business" should be done, if at all, by the Legislature. The Department's attempt to deprive Simpson of the benefits of the Section 4281 deduction conflicts with the general understanding of the nature of the business of parent holding companies of nonfinancial businesses. If Washington tax policy is to depart from that understanding, that policy choice is not the Department's to make. This Court should reaffirm Sellen and Rainier, and the responsibility of the Legislature -- not the Department -- for state tax policy. The judgment of the Superior Court in favor of the Department should be reversed.

II.

STATEMENT OF THE CASE

A. Procedural History of the Case.

The Department assessed Simpson additional B&O taxes during the period January 1, 1988, through December 31, 1991. (CP 34-35.) These

taxes were assessed under the "service and other activities" classification of the B&O tax. (CP 34-35.) The total tax and interest assessed was \$137,420, and was imposed on Simpson's revenues from interest, dividends, and other investment income. (CP 35.) Simpson paid this assessment in full on March 1, 1995. (CP 34.)

Between January 1, 1992, and May 31, 1996, Simpson paid an additional \$45,307 in "service and other activities" B&O tax and "financial business services" B&O tax to the Department. (CP 34-35.) These taxes were voluntarily paid on the same revenue sources to avoid the imposition of either interest or penalties. (CP 12.)

Simpson protested the Department's imposition of B&O taxes on this investment income and sought a refund of all taxes and interest paid on such revenues. (CP 34-35.) Simpson sought relief from the 1988 to 1991 assessment in three administrative appeals to the Department. (CP 35.) No relief was granted. (CP 35.) Simpson was then compelled to pay the protested amount, totaling \$137,420 (including accrued interest) and bring an action in Thurston County Superior Court to obtain a refund of all the taxes and interest paid. (CP 3, 4-9.)

Simpson moved for summary judgment on the basis that the tax payments were contrary to Washington law. (CP 10.) The Superior

Court (Hon. Christine Pomeroy) granted summary judgment to the Department. (CP 291-92.) Simpson now seeks direct review of this order by this Court. (CP 293-96.)

B. Overview of Simpson Investment Company.

Simpson¹ was formed in 1985 as the parent holding company of Simpson Timber Company and its subsidiaries, Simpson Paper Company and its subsidiaries, Simpson Extruded Plastics Company and its subsidiary, and Simpson Foreign Sales Company. (CP 84.) The business of Simpson, its subsidiaries and their subsidiaries during all relevant periods was timber production, forest products manufacturing, and plastic pipe manufacturing; Simpson owned 100 percent of each of its subsidiary corporations. (CP 84.)

¹Although Simpson's corporate name includes the words "Investment Company," those words should not be read as descriptive of Simpson's business. Rather, the term "investment company" has historical significance to the Simpson family of companies because it was the name adopted for the first corporate family holding company in the early twentieth century. R. Spector, Family Trees: Simpson's Centennial Story, at 16 (1990). The "Investment Company" name within the Simpson family of companies thus dates back nearly 100 years. The "Investment Company" name was dropped in the intervening years but "[m]any years later, the . . . family revived the Investment Company name, though its purpose was different." Family Trees, at 31. That "revival" was the organization of Simpson Investment Company as a holding company for all of Simpson's timber, lumber, paper, pulp, plastic pipe and other units. Family Trees, at 199 and 206; see (CP 84-88).

The management philosophy of Simpson and its subsidiaries dictates that each of the major operating units be separately incorporated. (CP 85.) This enables each company to equally compete for capital funding from the shared resources of the group, and permits the protection of the assets of each operating company by limiting liability exposure. Id. In addition, the daily management of the operations is decentralized to promote better response to business conditions unique to each line of business, and to allow each corporation to absorb the normal costs of a fully self-sustaining organization. Id.

The internal organization of Simpson is consistent with the corporate services provided to the operating subsidiaries. Id. As the parent holding company, Simpson provided centralized administrative services to the entire group of Simpson Companies. Id. These services included accounting and finance, credit, human resources, legal, management and information services, public affairs, risk management, tax, treasury, cash management and real estate property management. (CP 85, 90-93.) Each of these departments performs the following functions:

1. Accounting/Finance. Accounting and finance services are provided to the Simpson companies through several sections: Internal

Audit reviews the companies' books and practices; Treasury negotiates loan and bank agreements; Accounts Receivable/Payable processes invoices and receipts; Savings Plans Administration and Accounting administers contributions and withdrawals, enrollments, loans and statements for employee savings plans; Capital Assets processes fixed asset documents and provides guidance and training in accounting for capital expenditures; Salaried Payroll administers and processes salaried and pension payrolls and calculates, withholds and pays taxes and files tax returns; Policies and Procedures aids operating areas in meeting Simpson's objectives; and Records Retention reviews record needs, provides guidelines for retention, and releases records for destruction. (CP 91.)

This section has² 41 employees. Id.

2. Credit. Credit approves new customers and approves orders for shipment, ensures payment, provides collection services and provides documentation service on letter of credit and export shipments.

Id. This section has five employees. Id.

3. Human Resources. Human Resources manages the design of salaried cash compensation programs (base pay, bonuses and incentives), administers job evaluation and relocation programs, consults

²Numbers of employees are given as of 1995. See (CP 91).

with the companies on the design of productivity incentive plans, administers salary reviews and maintains the organizational chart for all companies. Id. Additionally, the Human Resource Department manages the design and administration of benefits and pension programs, manages training and employee development, consults with local operations on labor or employee relations issues, collective bargaining agreements, and arbitrations, and consults with operations in redesigning organizations. (CP 91-92.) This section has 30 employees. Id.

4. Legal. Legal assists with any legal matter involving the company or an employee's work. Id. It reviews all legal matters' and documents, reviews and negotiates contracts. (CP 92.) This section has ten employees. Id.

5. Management Information Services. This department evaluates hardware and software, maintains company-wide communications systems and works with locations to set corporate standards. Id. This section has 44 employees. Id.

6. Public Affairs. Public Affairs handles public relations and legislative and regulatory issues. Id. This section has eight employees. Id.

7. Risk Management. Risk Management reviews risks at individual operations and for the consolidated group as a whole. Id. It performs audits, directs fire prevention programs, negotiates insurance coverage for all companies and monitors safety performance for all mills by establishing safety standards, reviewing laws, and consulting with operations on safety programs. Id. This section had five employees. Id.

8. Tax. Tax determines if Simpson has a sufficient state presence to be required to file returns; it also manages audits, engages in tax planning, handles corporate structuring and shareholder tax issues, provides advice to operations on tax issues, and performs property tax reviews, real property valuations, coordinates property tax audits of locations and provides training, tax advice and planning. (CP 93.) This section has seven employees. Id.

9. Treasury. Treasury selects and monitors performance of investment managers for pension and 401(k) funds, consolidates operational plans and creates a corporate forecast. Id. This section has eight employees. Id.

10. Cash Management. Cash Management handles cash flow needs for the company and ensures the efficient use of money. Id. It is the investment income generated by this section's cash management

program and other investments that has been denied the Section 4281 deduction by the Department. Id. The cash management section has two employees. Id.

11. Property Management/Real Estate. This department provides real estate assistance in the negotiation, processing and management of real estate acquisitions, sales, leases and exchanges for Simpson and its subsidiaries. Id. It also performs all activities of two subsidiary companies, Simpson Properties Inc. and Simpson Tacoma Land Company. Id. This section has three employees. Id.

C. Overview Of Simpson's Subsidiaries.

Simpson had four primary operating subsidiaries for which it performed the functions just described during the relevant taxing period:

1. Simpson Timber Company. Simpson Timber Company was incorporated on June 29, 1984, and is a successor to the original Simpson Timber Company, a Washington corporation organized in 1895. (CP 86.) The Company has been in the business of growing and harvesting timber on its own land and, since the 1940's, has also been in the business of manufacturing and selling wood products including lumber, plywood and doors. (CP 85.) These activities include the operation of several lumber,

plywood and door manufacturing facilities in Washington, Oregon and California. (CP 85-86.)

2. Simpson Paper Company. Simpson Paper Company has been primarily engaged in the manufacture and sale of pulp and paper through predecessor entities since the mid-1950's. (CP 86.) Simpson Paper Company was incorporated in 1976 and is the successor of a closeout merger of Simpson Lee Paper Company. (CP 86.) For portions, or all of the period from 1988 to the present, Simpson Paper Company has directly owned or operated pulp and paper manufacturing facilities in Pennsylvania, Michigan, Ohio, Iowa, California, Oregon, Vermont, and New York. (CP 86.) It also owned 100 percent of the stock of its subsidiaries, Simpson Tacoma Kraft Company, Simpson Pasadena Paper Company and Simpson Plainwell Paper Company, which operate three additional pulp and paper manufacturing facilities in Washington, Texas, and Michigan, respectively during the relevant time period, but the stock of Simpson Plainwell Paper Company was sold in June 1987. (CP 86.)

3. Simpson Extruded Plastics Company. Simpson Extruded Plastics Company (for a time known as Pacific Western Extruded Plastics Company) was engaged primarily in the manufacture and sale of extruded plastic pipe and electrical conduit until the sale in September 1995 of all

the assets of this company, except the stock of Pacific Western Resin Company and the site of a closed facility in Downey, California, the latter of which was sold in 1997. (CP 86.) The Company was also involved, through its 100 percent owned subsidiary Pacific Western Resin Company, in the manufacture of PVC resin from May 1990 through September 1991, at which time all assets of this company were sold. (CP 86-87.)

4. Simpson Foreign Sales Company. Simpson Foreign Sales Company was a foreign sales corporation organized under Section 922 of the Internal Revenue Code. (CP 87.) The Company made sales of products manufactured by other Simpson Companies to customers in foreign countries. (CP 87.) This Company was dissolved on March 31, 1995. (CP 87.)

D. Simpson's Investment Income.

Simpson's major source of revenue was B&O tax-exempt dividends from its subsidiaries. (CP 35); see RCW 82.04.4281. In addition to these dividends, Simpson also derived income from investment income. (CP 35.) The Department assessed the disputed B&O tax and interest on Simpson's "investment income" which it received from the following three revenue sources (plus minor amounts of interest earned from notes and contracts):

1. Interest on Savings and Bank Deposits. Simpson operates a "cash management" system to fully utilize all of the liquid resources of the Simpson group of related companies. (CP 94.) Cash management programs are developed by banks for their customers and are designed to minimize outside borrowing by first utilizing all of the liquid resources of the related entities. (CP 242.) Under Simpson's cash management system, each subsidiary maintains one or more deposit and disbursement accounts and Simpson maintains a concentration account. (CP 94-95.) Funds are moved back and forth between these entities or accounts within the internal business structure on a daily basis. (CP 94-95.) When one subsidiary has excess funds in its checking account, these funds will be used by the subsidiaries having deficits before that company resorts to outside or bank financing. (CP 95.) This "money" or "cash management" system is coordinated by Simpson. Id.

As noted above, Simpson maintains a concentration account as part of the cash management system. Id. Simpson and all the other Simpson operating companies also maintain subsidiary accounts and payroll accounts. Id. Deposits and disbursements from accounts maintained by the subsidiary companies flow through Simpson's concentration account. Id. The movement of cash between bank accounts determines the daily

cash position for Simpson as well as for all of the Simpson entities. Id. This function also determines the daily consolidated borrowing requirements or investment opportunities for the companies. Id. The bank accounts maintained in the name of each Simpson subsidiary utilize a daily target zero account balance. Id.

The cash management system has no written evidences of indebtedness memorializing the funding activity or purporting to create any credit-debtor relationship between the parties, on either a demand or term payment basis. Id. The daily transfers of cash between the parent and subsidiary accounts may result in excess cash available for investment in the concentration account. (CP 95-96.) Simpson invests these account funds in overnight, short-term deposits. (CP 96.) The interest income earned on the short-term investments is deposited at maturity into the Simpson concentration account and is included in its beginning daily bank account balance. (CP 95-96.) All excess cash is then invested in the name of Simpson as funds manager. (CP 96.)

In essence, the cash management system is a sophisticated checking account that earns interest on the funds on deposit each day. Id. The Department imposed B&O tax on the interest and other investment income generated through the cash management system. (CP 34-36.)

2. Dividends From Stock in Competitor Companies. Simpson also owned small amounts of stock in competitor forest products companies in order to track the activities of competitors and to obtain financial information which was available to shareholders of those companies. (CP 98.) This information was then used in an industry database maintained by Simpson, which was used for tracking its performance against competitors and for setting financial rating objectives. Id. The portfolio of stock was acquired strictly with the objective of gaining nonconfidential financial and other public information about these competitor companies. Id.

Simpson typically acquired 100 shares of common stock in each publicly traded competitor. Id. In some cases Simpson ended up with more than 100 shares because some of the companies had stock splits or stock dividends. Id. When the number of shares increased to a point where it was practical, Simpson would, from time-to-time, sell excess shares to bring the balances down to 100 shares. Id.

The Department imposed B&O tax on the cash dividends Simpson received from this portfolio of stock. (CP 34-36.)

3. Market Hedging and Futures Trading. Lumber and plywood commodity price hedging began at Simpson Timber Company in

1977. (CP 111.) The trading was in operation at Simpson Timber Company and later Simpson from 1977 to April 1990. (CP 110.) The purpose of the trading was to reduce the price volatility inherent in the sale of lumber and plywood commodity items. (CP 111.)

The price hedge was accomplished by selling contracts for the future delivery of lumber on the Chicago Mercantile Exchange when those prices exceeded the Corporate Plan Forecast or were higher than regular customers were willing to pay at the time. (CP 111.) When the expiration date for the futures contract approached, the contract was closed-out and an equal volume of lumber was sold to Simpson's normal customers at the market price. Id. If commodity price levels had fallen since the date of the original futures contract sale, then there would be a profit from the futures contract recorded in the "Futures Trading" account.

Id.

If market prices had risen since the sale of the futures contract, a loss would be recorded in the Futures Trading account when the contract was closed, but the lumber prices received from Simpson's customers would be higher than expected several months earlier. Id. The gains and losses from the futures contracts were accumulated in one ledger account for financial control purposes. Id. The amount was used to adjust

average sales per thousand board feet in quarterly or annual comparisons.
(CP 111-12.)

The Department assessed B&O tax on the income generated from these price hedging activities. (CP 34-36.)

III.

STANDARD OF REVIEW

This case turns on the interpretation of the B&O tax deduction set forth in RCW 82.04.4281. The Superior Court resolved this matter on summary judgment; as the material facts were undisputed, the court's rulings are subject to de novo review by this Court. E.g., Timberline Air Service, Inc. v. Bell Helicopter-Textron, Inc., 125 Wn.2d 305, 311, 884 P.2d 920 (1994) (citation omitted) (reversing summary judgment).

IV.

ARGUMENT

- A. Simpson Is Entitled to the Benefits of the Section 4281 Deduction Because Simpson Is Not a "Financial Business," as That Term Has Been Defined and Applied by the Legislature and by This Court -- and, Until Recently, by the Department.

The Department's underlying authority for the imposition of a B&O tax is set forth in RCW 82.04.220. Under RCW 82.04.220, the Department levies and collects B&O taxes from every person engaging in

business activities.³ The tax is measured by the application of rates against the value of the person's products, gross proceeds of sales, or gross income of the business. The Legislature, however, has granted several deductions and exemptions from the B&O tax. Among these is Section 4281, which grants a deduction for the investment income of nonfinancial businesses, and for amounts derived as dividends by a parent company from its subsidiaries:

In computing tax there may be deducted from the measure of tax amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such, and also amounts derived as dividends by a parent from its subsidiary corporations.

RCW 82.04.4281.

Simpson derives a substantial amount of its operating funds from dividends paid by its subsidiary companies. See (CP 280-81). The Department has determined these dividends are exempt from B&O tax under Section 4281. (CP 280-82.)⁴ The Department, however, refuses

³Person is defined in RCW 82.04.030 to include companies and corporations, such as Simpson and its subsidiaries.

⁴In the Department of Revenue's original audit of Simpson, the Department took the position that Simpson's dividend and interest income was actually charges for services. See (CP 280-82). This included the dividends paid by the subsidiaries to Simpson Investment Company. The Department, however, later reversed itself after determining that the dividends from subsidiaries were bona fide dividends, entitled to exemption from B&O tax under RCW 82.04.4281. See (CP 280-82).

to recognize the Section 4281 deduction for Simpson's investment income, and has imposed B&O tax on the interest income generated through Simpson's cash management system, the dividends from the portfolio of stock in competitor companies, and the small amount of income earned from hedging. Although the Department recognizes Simpson derived these amounts from investments or the use of money for investments, the Department takes the position that Simpson is not entitled to the Section 4281 deduction because it is a "financial business."

Simpson and its predecessor companies have, for nearly 100 years, been engaged in the forest products business. The Department, however, has focused solely on three relatively minor activities of Simpson, in reaching the conclusion that Simpson is a financial business: (1) the operation of a cash management system; (2) the maintenance of a portfolio of stock held by Simpson in its publicly traded competitors; and (3) a short period of market hedging and futures trading. These three activities do not change the character of Simpson's business; Simpson is a holding company undertaking numerous administrative activities for its timber, forest products and plastic pipe subsidiary companies. In fact, Simpson's cash management system was overseen by only two employees, and the portfolio of stock in competitor companies was a part-time duty of only

one Simpson employee. Thus, no more than three of Simpson Investment Company's 172 employees were engaged in these so-called "financial" activities, yet the Department nevertheless concluded that Simpson is a "financial business."

The Section 4281 deduction for investment income has been in practically the same form since the deduction first appeared in 1935. See Laws of 1935, ch. 180 §12; see also John H. Sellen Constr. Co. v. Department of Revenue, 87 Wn.2d 878, 884, 558 P.2d 1342 (1976).⁵ In 1970, the Legislature amended the deduction, so that it expressly extended to amounts derived as dividends by a parent from its subsidiary corporations. 1970 1st Ex. Sess. ch. 101, § 2.⁶ Then in 1993, the Legislature amended, not the Section 4281 deduction, but the B&O tax rate section under RCW 82.04.290. See Laws of 1993, 1st Spec. Sess.,

⁵This Court's goal in interpreting a statutory provision is to effect the Legislature's intent. E.g., Dawson v. Daly, 120 Wn.2d 782, 791, 845 P.2d 995 (1993) (citation omitted). That intent is ascertained from the language of the statute, or from extrinsic aids, such as the legislative history. E.g., State v. Hennings, 129 Wn.2d 512, 522, 919 P.2d 580 (1996) (citation omitted).

⁶The only other amendment to the Section 4281 deduction occurred in 1980, when the legislature separated the several B&O tax deduction sections then listed as subsections under RCW 82.04.430, into separate sections. For example, the Section 4281 deduction was codified under RCW 82.04.340(1) prior to the 1980 amendment. Laws of 1980, ch. 37 § 2. The substantive content of the deductions did not change.

ch. 25. Through this amendment, the Legislature established a lower tax rate "upon every person engaging within this state in banking, loan, security, investment management, investment advisory, or other financial businesses." Laws of 1993, 1st Spec. Sess., ch. 25. Prior to this 1993 amendment, "banking, loan, security, investment management, investment advisory, or other financial businesses" were not singled out for lower tax rates or any other special tax treatment. Notably, in this amendment, the Legislature used nearly identical language to identify the financial businesses which would receive the lower B&O tax rate, as it had previously used to identify the businesses excluded from the Section 4281 deduction.⁷ The only difference in the language now found in RCW 82.04.290 was the inclusion of the further descriptive words "investment management" and "investment advisory."

Moreover, in the same session, the Legislature also amended RCW 82.04.055(2)(f), to specifically define the terms "financial institution" and "financial services." These terms thus became defined as follows:

Financial services provided by financial institution. The term "financial institution" means a corporation, partnership, or other

⁷When the Legislature uses similar words in different parts of a statute, the court presumes the legislature intended those words to have the same meaning throughout the statute. E.g., State v. Akin, 77 Wn. App. 575, 580-81, 892 P.2d 774 (1995) (citation omitted).

business organization chartered under Title 30, 31, 32, or 33 RCW, or under the National Bank Act, as amended, the Homeowners Loan Act, as amended, or the Federal Credit Union Act, as amended, or a holding company of any such business organization that is subject to the Bank Holding Company Act, as amended, or the Homeowners Loan Act, as amended, or a subsidiary or affiliate wholly owned or controlled by one or more financial institutions, as well as a lender approved by the United States secretary of housing and urban development for participation in any mortgage insurance program under the National Housing Act, as amended. The term "financial services" means those activities authorized by the laws cited in this subsection (2)(f) and includes services such as mortgage servicing, contract collection servicing, finance leasing, and services provided in a fiduciary capacity to a trust or estate.

Laws of 1993, Spec. Sess. ch. 25 § 201.

By specifically referencing "a holding company" in defining the organizations included in the definition of "financial institution," the Legislature evidenced its intent that the term "financial businesses" did not include all holding companies, but only those holding companies which were the parent organizations of financial and other moneyed corporations. Moreover, it must be presumed that "the legislature was acquainted with and had in mind, the judicial construction of former statutes on the subject, and that the statute was enacted in the light of the judicial construction that the prior enactment had received, or in the light of such existing judicial decisions as have direct bearing on it." Ashenbrenner v. Department of Labor and Industries, 62 Wn.2d 22, 26, 380 P.2d 730

(1963), citing 50 Am. Jur., Statutes § 321, p. 312. The application of this presumption to the 1993 amendment becomes critical, in light of this Court's decision in John H. Sellen Construction Co. v. Department of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976).

In Sellen, this Court was asked to interpret the portion of the Section 4281 deduction which allowed a B&O tax deduction for amounts a company derived from investments, or the use of money for investments. The Sellen taxpayers had invested surplus working capital, reserves and trust funds in short term investments, including time certificates, commercial paper, purchase agreements, savings accounts, and stocks and bonds. The taxpayers were just as obviously not "moneyed corporations" in the traditional sense of the term, as they were engaged in nonmoneyed businesses such as general contracting, beer manufacturing, prepaid medical and health care services, and cemetery grounds maintenance. The Department had audited the taxpayers' businesses, and assessed B&O tax upon their investment income, alleging that such income was not entitled to the Section 4281 deduction, because the taxpayers supposedly were "financial businesses."

The taxpayers successfully appealed the assessments at the superior court level, and the Department then directly appealed to this Court. This

Court first applied the rule of statutory construction that words in a statute are to be given their ordinary and common meaning absent a contrary statutory definition. Sellen at 882. Since chapter 82.04 RCW contained no definition of financial businesses, this Court found that the common meaning of the phrase contemplated "a business whose primary purpose and objective is to earn income through the utilization of significant cash outlays." Sellen at 882 (emphasis added). This Court then looked to the dictionary to ascertain the meaning of financial businesses, and relied upon the definition of "financial institution." Citing Webster's Third International Dictionary (1968), the Court defined a "financial institution" as follows:

[A]n enterprise specializing in the handling and investment of funds (as a bank, trust company, insurance company, savings and loan association, or investment company).

Sellen at 883.

This Court rejected the Department's alternative interpretation, under which any taxpayer engaged in investing of income (no matter how incidental) should be treated as a "financial business":

If we adopt appellant's [i.e., the Department's] interpretation of RCW 82.04.430(1), then few taxpayers, if any, making incidental investments of surplus funds could receive the deduction. Appellant equates investing any income with being a financial business and, in effect, this renders the statute a nullity. By interpretation we should not nullify any portion of the statute. . . .

Further, the legislature does not engage in unnecessary or meaningless acts, and we presume some significant purpose or objective in every legislative enactment.

Sellen at 883 (citations omitted). This Court also applied the rule of ejusdem generis,⁸ and held that the phrase "other financial businesses" had to be read in conjunction with the specific terms "banking, loan and security." This Court held that the generic phrase "other financial businesses" only extended to businesses that were comparable to those listed in the specific categories, i.e., banking, loan and security businesses. The Court then concluded that the Sellen taxpayers' businesses were not similar to banking, loan or security businesses.⁹

⁸The rule of ejusdem generis provides that when general terms appear in a statute in connection with precise or specific terms, the precise terms modify, influence or restrict the interpretation or application of the general terms when both are used in sequence or collocation in the legislative enactment. Sellen at 883-84.

⁹Having applied the rules of statutory construction and finding that the Sellen taxpayers' businesses were not "financial businesses" for purposes of the Section 4281 deduction, this Court also chided the Department for reversing its long-standing interpretation of the deduction language:

Appellants' [i.e., the Department's] previous interpretation of the statute is consistent with our position. RCW 82.04.430(1) [the predecessor to RCW 82.04.4281] in practically identical form and language has been a part of the revenue act since 1935, and thereunder appellant audited respondents for a number of years and approved their deductions for investment incomes.

Sellen at 884.

When the Legislature acted in 1993, by adopting a statutory definition of "financial institution," which is even narrower than the meaning attributed to the term by this Court in Sellen, the Legislature is presumed to have intended to confirm the scope of the related term "financial business" (which this Court in Sellen defined as equivalent to a "financial institution"). This intent is further evidenced by the Legislature's contemporaneous 1993 amendment to RCW 82.04.290, adding the modifiers "investment management" and "investment advisory" (preceding the phrase "or other financial businesses") in the rate setting section of the statute. The inclusion of these additional terms indicates that the Legislature intended "financial businesses" to be limited to moneyed entities, in the traditional, narrow, sense of the term. Under these definitions, Simpson simply is not a financial business, because it is not an enterprise specializing in the handling and investment of funds. Like the taxpayers in Sellen, Simpson only makes incidental investments of surplus funds; its primary business is that of a holding company for its timber, forest products and plastic pipe producing subsidiaries. Simpson's business, as a holding company for subsidiaries engaged in the timber business, cannot fairly be characterized as comparable to a banking, loan, or security business.

Until recently, the Department would have agreed. Following the Sellen decision, the Department issued ETB 505.04.109, 2 ETB 309, dated March 4, 1977, to interpret this Court's decision in Sellen. (A copy of ETB 505.04.109 is attached to the Statement of Grounds for Direct Review, as Ex. A.) ETB 505.04.109 provided the following interpretation and guidelines for implementing the Sellen decision:

The court did not define "investments" in its opinion. However, it noted that enterprises "specializing in the handling and investment of funds" would not be entitled to the statutory deduction but that those "making incidental investment of surplus funds" should receive the deduction.

Under the holding of the court in Sellen, income from the incidental investment of surplus or excess funds by persons who are not themselves in a security, investment, or financial business is not subject to tax.

However, no deduction is permitted with respect to

1. interest or similar charges from extension of credit to customers;
2. interest or similar financial charges relating to real estate transactions (see RCW 82.04.390); nor
3. income from activities which are essentially in competition with financial businesses where such activities are a regular part of the taxpayer's normal business practice.

ETB 505.04.109, p. 2 (emphasis added).

Had the Department continued to comply with its own interpretation of Sellen as set forth in ETB 505.04.109, the Department

would have allowed Simpson the Section 4281 deduction. Under the guidelines, Simpson does not specialize in the handling and investment of funds -- it is a parent holding company for subsidiaries engaged in the timber, forest products and plastic pipe businesses, making incidental investments of surplus funds under a common cash management program. Nor are Simpson's investments generated from the extension of credit to customers, or related to real estate transactions; and, most assuredly, Simpson's activities are not in competition with financial businesses, such as banks, security and loan or investment companies. Thus, under the Department's own contemporaneous interpretation of Sellen, ETB 505.04.109, Simpson is not a financial business precluded from the Section 4281 deduction.

Six years after Sellen and five years after the Department issued ETB 505.04.109, this Court was again asked to interpret the Section 4281 deduction. In Rainier Bancorporation v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982); the taxpayers, like those in Sellen, challenged the Department's application of the investment portion of the Section 4281 deduction and, in particular, the Department's interpretation of the term "financial business." Unlike the taxpayers in Sellen, however, Rainier Bancorporation was a bank holding company registered with the

Governor's of the Federal Reserve System pursuant to the Bank Holding Company Act of 1956. It had three wholly owned subsidiaries -- Rainier Bank, Rainier Mortgage Company and Rainier Credit Company -- and its business activities during the tax period were the receipt of dividends and interest from marketable securities, gains on the sale of securities, and interest received from subsidiaries for financing in the form of equity capital, loans and advances.

This Court again applied the rules of statutory construction as it had done in Sellen, and reiterated that the common meaning of "financial businesses" contemplated a business whose primary purpose and objective was to earn income through the utilization of significant cash outlays. Rainier at 673. This Court then held that one indicia of Rainier's status was the fact that most of the money loaned to its subsidiaries was borrowed from outside sources (less than one half of the funds came from Rainier's surplus funds). Rainier at 673. The Court next applied the rule of ejusdem generis, as it had done in Sellen, and found that, although technically Rainier did not fall within the specific definition of a banking, loan or security business, by loaning money to its subsidiaries, its activities were nevertheless similar or comparable to the specific banking,

loan and security businesses excluded from the benefit of the Section 4281 deduction. Rainier at 673-74.¹⁰

Simpson's activities are far closer to those of the taxpayers in Sellen, than to those in Rainier. In fact, other than being a holding company, a status held nondeterminative by this Court,¹¹ Simpson has few other similarities to Rainier Bancorporation. First, although Simpson is a holding company for several subsidiaries, it received its investment income from the surplus investment of cash, dividends from stocks in competitor companies and some minor price-hedging and futures trading;

¹⁰This Court also relied upon the rule that tax deductions must be narrowly construed, and, coupling that rule with its finding that Rainier's activities were similar or comparable to those of bank loans or security businesses, concluded that Rainier was ineligible for the Section 4281 deduction from B&O tax. This Court was careful, however, to point out that its decision was to be narrowly construed:

Our decision today is limited to holding companies, such as Rainier, which are engaged in a "financial business." We venture no opinion on the question of whether a holding company that makes its loans solely out of its own surplus funds is subject to the B&O tax.

Rainier at 674 (emphasis this Court's).

¹¹This Court specifically declined to hold that holding companies are per se financial businesses. Nevertheless, the Department has essentially taken the position that because of their use of cash management systems, any holding company is a "financial business," and therefore not entitled to the Section 4281 deduction. This interpretation is inconsistent with this Court's decision in Rainier, wherein this Court was careful to limit its decision to holding companies which were essentially moneyed businesses.

in comparison, Rainier's investment income came primarily from interest received on loans from outside sources to its subsidiaries. Second, Rainier was a bank holding company registered with the Federal Reserve system pursuant to the Bank Holding Company Act of 1956, 12 U.S.C. § 1844; Simpson is neither a bank, nor is it registered with the Federal Reserve system.¹² Third, Simpson does not specialize in the handling and investment of funds. Although Simpson itself does not grow timber or manufacture or produce forest products or plastic pipe, Simpson nevertheless engages in these businesses through the provision of numerous administrative and management services for its subsidiaries, who do engage in these businesses. Simpson, as the parent company, does not have as its primary purpose and objective the earning of income through the utilization of significant cash outlays; Simpson's primary purpose and objective is marshalling people and capital to produce a profit in the timber, forest products and plastic pipe businesses.

In sum, the Department's insistence that Simpson is a financial business cannot fairly be squared with the statutory language; this Court's

¹²Additionally, Rainier's three wholly owned subsidiaries, Rainier Bank, Rainier Mortgage Company and Rainier Credit Company, were each engaged in financial businesses, including deposit and lending activities; Simpson's subsidiaries are all engaged in the production of timber and the manufacture and sale of forest products and plastic pipe.

interpretations of that language; or the Legislature's application of those interpretations by recent amendments. The Department's claims in this case even conflict with the Department's own interpretations of the Section 4281 deduction -- except for the Department's most recent interpretation, the validity of which is at the heart of the present dispute, and which cannot fairly be upheld under basic principles of statutory construction and interpretation.

B. A Holding Company Generally Is Not Treated as a "Financial Business," Unless Financial Business Is Specifically Defined to Include Holding Companies. Nothing in the Language or History of Section 4281 Supports a Departure From These Well Established Principles of Business Law and Practice.

As stated above, this Court in Rainier limited its decision to "holding companies, such as Rainier Bancorporation, which are engaged in a 'financial businesses,'" and expressed no opinion regarding whether a holding company, like Simpson, that makes loans solely out of its own surplus funds is subject to the B&O tax. Rainier at 674. The Department nevertheless has taken this Court's expression of no opinion as license to declare all holding companies (whether or not engaged in nonmoneyed businesses) who make loans to subsidiaries from any source, to be "financial businesses" and thus denies them the Section 4281 deduction. This construction of holding companies by the Department ignores the

nature and characteristics of such companies, and the consistent treatment given to them by other states.

A holding company has been defined as "a corporation organized to hold the shares of another or other corporations. Such companies become legally possible by virtue of the legislation which is said to exist in nearly all the states, which authorizes a corporation to hold and own the capital stock of other corporations." Fletcher Cyclopedia of Corporations, § 2821 at 333 (perm. ed. 1997) (footnote omitted). The United States Supreme Court has characterized the dominant characteristic of a holding company to be its ownership of securities which make it possible to control or substantially influence the policies and management of the operating companies in a particular field of expertise. North American Co. v. Securities & Exchange Commission, 327 U.S. 686, 701, 90 L. Ed. 945, 66 S. Ct. 785 (1946). As one treatise writer has observed:

In its essential meaning the holding company, as the name implies, is merely a corporation organized to hold in its treasury the stocks or bonds of other corporations. But the phrase in actual usage is ordinarily confined to the corporation which exercises some measure of administrative control over the corporations the stock of which lie in its treasury. It stands in contrast to the investment company, which embodies little or no direct purpose of control.

2 A. Dewing, The Financial Policy of Corporations, Chapter 6, The Holding Company, at 1032 (4th ed. 1941) (emphasis added).

Whether a holding company is to be treated as a "financial business" generally depends on the legislative enactments and case law of a particular jurisdiction. Since Washington has not specifically resolved this issue, it is appropriate to consider how holding companies have been treated in other jurisdictions:

- In California, the court was asked to determine whether Marble Mortgage Company ("Marble") was a financial corporation for tax purposes. Marble Mortgage Co. v. Franchise Tax Board, 241 Cal. App. 2d 26, 50 Cal. Rptr. 345 (Cal. App. 1966). Marble dealt in first deeds of trusts on realty initially acquired by Marble through the use of funds supplied to it by banks. The deeds of trust were thereafter assigned by Marble to institutional investors. Under the California Bank and Corporation Franchise Tax Act, Rev. & Tax. Code, § 23183 et seq., (the "Tax Code"), banks and financial corporations were taxed less favorably than nonfinancial corporations. The court held Marble was a financial corporation under the California Tax Code and the policies underlying the code. The court determined the term "financial corporation," applied to corporations dealing in "moneyed capital," and that because the financial corporation dealt in money and capital, they were distinguishable from mercantile, manufacturing, and business corporations. Id. at 349. The

court then defined moneyed capital as bonds, notes, or other evidence of indebtedness. Id. at 349, citing 12 U.S.C. § 548.1(b).¹³ Lastly, the court concluded:

[W]e believe that a corporation may not be classed as financial under the state act unless it is in substantial competition with the business of national banks. . . . The word 'financial' when used with reference to corporations indicates dealing in money as distinguished from other commodities."¹⁴

Id. at 350.

Thus, under the Marble analysis, a corporation is a financial corporation for purposes of taxation only if the corporation is in substantial competition with banking institutions. To be in substantial competition with a bank, a corporation must deal in moneyed capital, i.e., bonds, notes, or other evidence of indebtedness. Under this test, Simpson is not a financial business or corporation. It does not deal in moneyed capital and it is not in substantial competition with the business of national banks. Instead, Simpson is a business corporation competing in the business of timber, forest products and plastic pipe.

¹³12 U.S.C. § 548(b) was repealed after the Marble case was decided.

¹⁴This holding in Marble, i.e., a corporation may not be classed as financial under California law unless it is in substantial competition with banks and deals in money as distinguished from other commodities, is remarkably similar to the Department's ETB 505.04.109 which the Department issued following this Court's decision in Sellen. See § IV.A, supra, at 28-30.

• New Jersey has also addressed the issue of whether a holding company qualifies as an investment company for tax purposes, in International Thomson Business Information, Inc. v. Director, Division of Tax, 14 N.J. Tax 424 (N.J. Tax Ct. 1995). The holding company claimed that it was an investment company which was formed for the purpose of protecting, maintaining and coordinating the investments of its nine subsidiaries, and that all expenses incurred were to support this purpose. Id. at 429. Unlike California, however, New Jersey provides special tax treatment for investment companies in order to encourage such companies to locate in New Jersey rather than New York. New Jersey's tax code defines "investment companies" as follows:

[A]ny corporation whose business during the period covered by its report consisted, to the extent of at least 90% thereof of holding, investing and reinvesting in stocks, bonds, notes, mortgages, debentures, patents, patent rights and other securities for its own account

Id. at 431, quoting N.J.S.A. 54:10A-4(f).

New Jersey had also adopted regulations to establish when a corporation would be deemed an investment company for tax purposes. The regulations established a two-part test -- a business test and an asset test. The business test considered whether the corporation derived ninety percent or more of its total income before deductions, from cash or from

investment type assets. The asset test considered whether the corporation incurred ninety percent or more of its total deductions from holding, investing, and reinvesting in cash and/or investment type assets. A corporation was required to meet the ninety percent requirement of both tests in order to qualify as an investment company.

The court first interpreted New Jersey's regulations in view of a corporation's management activities:

The pertinent regulations require that qualified investment activities and assets may not include activities or assets attributable to "[t]he direct day-to-day management of operations of affiliated corporations or the actual providing of services, directly or as an intermediary, for the benefit of affiliated corporations."

Id. at 433, quoting N.J.A.C. 18:7-1.15(b)(4). The court then noted that International Thomson's interactions with its subsidiaries included the setting and monitoring of financial goals, reviewing and approving business plans, and analyzing, on a monthly basis, the financial performance of each subsidiary. Thus, the court concluded that International Thomson failed to provide quantitative proof that less than ten percent of its activities were devoted to the provision of services or participation in its subsidiaries' day-to-day operations, or that the business and asset tests, when recalculated to take these activities into account, would reflect qualified investments of ninety percent or more.

Accordingly, International Thomson was deemed not to be an investment company and was denied the tax advantage.

Under the New Jersey test, Simpson would likewise not be considered an investment company or financial business because of its significant involvement in its subsidiaries' daily operations. The fact that Simpson is a holding company would not be determinative under the test New Jersey set forth in its rules. Thus, the issue of whether a holding company is considered a financial business for purposes of taxation is dependent on whether a state has specifically included holding companies in its taxing statutes.¹⁵ In other words, if the definition does not expressly provide for holding companies, then courts in other jurisdictions have simply held that holding companies are not financial businesses.

¹⁵Other jurisdictions have consistently included or excluded holding companies from preferred tax treatment through legislative enactment. Further examples can be found in United States Steel Corporation v. Gerosa, 7 N.Y.2d 454, 199 N.Y.S.2d 425, 166 N.E.2d 489 (1960) wherein U.S. Steel, a New York holding company doing no other business than that of holding the stock, coordinating and supervising the operation and at times finances of the subsidiaries, successfully challenged the City's claim that U.S. Steel was a financial business. In rejecting the City's assertion that holding companies are encompassed by this definition, the court looked to other local tax statutes containing this exact definition, but with the addition of the term "holding company." Thus, the court concluded that if the definition was to encompass holding companies, it would have expressly so provide.

Here, the Legislature has not defined "financial businesses" to include holding companies, generally. To the contrary, it has defined "financial institution" to include only those holding companies of business organizations chartered under the National Bank, Homeowners Loan and Federal Credit Acts. See RCW 82.04.055(2)(f). Obviously, the Legislature could define holding companies to be "financial businesses" -- although such a course would disregard the long established understanding of the nature and function holding companies play in the modern economy. What matters to the outcome of this case is that the Legislature has not chosen to depart from the understanding, and that choice is for the Legislature -- not the Department -- to make.

C. **The Department Erroneously Denied Simpson the Section 4281 Deduction Based on Simpson's Cash Management System.**

As noted above, the Department has focused solely on two relatively minor activities of Simpson in reaching its conclusion that Simpson was a financial business: (1) the operation of a cash management system; and (2) the maintenance of a portfolio of stock held by Simpson in its publicly traded competitors. Cash management products and services (which can be electronic or paper-based or which utilize software programs developed and marketed by banks) are commonly sold to

businesses like Simpson¹⁶ to allow the company to effectively manage its cash flow. (CP 220-21.) The typical cash management system includes income and disbursement accounts for each of the operating companies and a concentration account that funds, or provides funds to all of the other accounts. (CP 214.) The concentration account is generally owned by the parent corporation and will receive any excess funds from the subsidiary accounts, usually on a daily basis, for overnight investment. (CP 214.) This is not engaging in a financial business but is simply good financial management of the business enterprise. (CP 215.)

In summary, the organizational structure and cash management system utilized by Simpson is very typical of the structure and system used by many other major corporate organizations in this state and elsewhere. Like Simpson and its subsidiaries, these companies include manufacturers, retailers, service companies, high tech, utilities, trucking companies, chemical companies, food producers, and telecommunications and cable companies, all of whom are not, in any sense of the term,

¹⁶This Court may take judicial notice that cash management systems are now commonly used by businesses of all types and sizes. See, e.g., Wall Street Journal, Tues., Sept. 16, 1997, at B2 (Merrill Lynch advertisement). Under the Department's interpretation of the Section 4281 deduction, any business, no matter how small, would be considered a financial business if it used a cash management system typical of the type used by Simpson.

deemed to be financial businesses. (CP 215.) Indeed, if the Department's position was upheld, it would mean that few, if any, Washington taxpayers organized as parent and subsidiaries could receive the deduction granted by RCW 82.04.4281, if they operated a cash management system through which they earned income on the short-term investment of the surplus funds in those accounts.¹⁷

D. The Department's Recent Determinations Regarding the Section 4281 Deduction Are Inconsistent With Legislative Intent and This Court's Decisions, and Also Constitute Improper Rule-Making Under the APA.

Following Sellen, the Department issued a series of determinations addressing cash management systems and other issues regarding when a taxpayer would be considered a financial business. As shown, under the first of these determinations (ETB 505.04.109), Simpson could not fairly be classified as a "financial business." Following the issuance of ETB 505.04.109, the Department considered the issue of whether amounts from a parent company entered upon its books as "interest," which were calculated upon daily advances or disbursements of operating funds to the

¹⁷Moreover, from a tax policy standpoint, these cash management systems are internal electronic accounting devices which will enhance the business climate in this state and encourage the location of businesses here. If the Department's interpretation is adopted, businesses will be inclined to relocate their holding companies to those states with more favorable tax treatment for their investment income.

accounts of wholly owned subsidiary companies, were subject to the B&O tax. The Department first issued Determination No. 86-309, 2 WTD 83 (1986), in which the Department presumed to uphold the assessment of the B&O tax under these types of cash management systems. One year later, however, the Department reversed its position in Determination No. 86-309A, 4 WTD 341 (1987).

In 4 WTD 341, the taxpayer, like Simpson, had an internal corporate money management system through which the taxpayer essentially provided operating funds and collected operating income from its subsidiaries on a daily basis. Also, like Simpson, the taxpayer's system consisted of a network of banking accounts through which the taxpayer would "clean sweep" all the subsidiary accounts on a daily basis to manage the flow of corporate funds and maintain cost control records to determine how efficiently the corporate subsidiaries were operating. No actual loans were transacted and no notes or other evidences of any indebtedness were executed; no interest obligations or rates were agreed upon or secured. Additionally, the money management services were not offered to others nor was the parent company licensed, organized or equipped to provide money management services to others outside the corporate family.

The taxpayer, relying on Sellen and Rainier, alleged that it was not primarily engaged in a financial business merely because it performed the corporate money management functions of its own subsidiary businesses. The taxpayer argued that, unlike Rainier, it was engaged in research, development and manufacturing of aerospace and telecommunications products which were not financial businesses. The Department agreed with the taxpayer and, after describing the workings and benefits of cash management systems, concluded that the taxpayer's activity of marshalling its subsidiaries profits and losses through the application of the internal money management system, did not accrue taxable value. The Department further reasoned that the money management systems did not result in any actual payments or receipts to the taxpayer because these activities merely resulted in the moving of already taxed money from one pocket to another. 4 WTD 341 at 346.¹⁸

Moreover, the Department held that, even if the expenses of the money management system computed and designated as interest, were

¹⁸The Department further recognized in Determination No. 309A, that banks and other financial institutions had developed and marketed such programs and acknowledged that banking officials had testified before the Department that these money management systems were not in competition with banks, but were in cooperation with banks since the systems were driven by their own business dynamics rather than the traditional concept of investing funds for a direct, anticipated yield.

deemed to result in value proceeding or accruing to the taxpayer, the Section 4281 deduction applied because this was "precisely the kind of marshalling of assets which is contemplated by the statutory language, 'use of money as such.'" 4 WTD 341 at 347. The Department went on to apply the Sellen analysis of this Court, and concluded that the taxpayer's business was not financial in nature:

Under this statute there are two criteria for exemption. (a) The amounts must be derived from "investments or the use of money as such," and (b) the recipient of such amounts must not be a "financial business." Both criteria are satisfied in this case. Our analysis of the money management technique employed by the taxpayer and explained earlier herein reveals that it is simply the "use of money as such." It does not constitute the making of loans or other investments in any traditional sense, nor is it supported by any of the legal evidences of rights and obligations flowing between the taxpayer and its subsidiaries. Rather, it is precisely the kind of marshalling of assets which is contemplated by the statutory language, "use of money as such."

Moreover, business entities do not assume the characteristics or functions of "financial businesses" comparable to banks, loan companies, or investment companies, merely by virtue of performing internal fiscal functions. All businesses perform fiscal functions. All businesses assumably arrange and marshall their own financial affairs in such a manner as to achieve maximum cost and funding efficiencies. The degree of sophistication of such money management enabled by electronic banking technologies does not dictate tax liability under Washington State laws. Performing such functions for one's self neither constitutes engaging in "financial business," nor makes the performing entity a "financial business" by nature. Rather, it is an internalized, incidental function of any business enterprise and is not the taxable business activity in which it is primarily engaged. This is the cumulative rationale of the courts' decisions in the Sellen and

Wright/Schucart cases, supra, even though those decisions are not precisely on point with the taxpayer's case here.

4 WTD 341 at 347 (emphasis added).¹⁹

One year later, however, in Determination No. 88-246, 6 WTD 89 (1988), the Department held that interest income derived from regular and recurrent loans or surplus funds was not deductible under the Section 4281 deduction. In 6 WTD 89, the Department presumed to establish a "bright line test" for determining if a parent company's money management system constituted the mere "use of money as such" for purposes of the Section 4281 deduction:

1. Company funds are moved back and forth between entities or accounts within the internal business structure on a daily basis;
2. The subsidiary or affiliated entities whose daily operations are funded in this manner are majority owned and controlled by the same parent or its owners;
3. There are no written evidences of indebtedness memorializing the funding activity and creating any creditor-debtor relationship between the parties, on either a demand or term payment basis;
4. The functions performed to accomplish the money movement between entities or accounts are the same as

¹⁹Notably, the Department interpreted this Court's decision in Rainier as a "very limited ruling concerning . . . only a holding company of institutions which were clearly 'financial businesses' by definition." 4 WTD 341 at 345 (emphasis added).

those performed by banks and other financial institutions, utilizing a daily targeted minimum or zero account balance method.

6 WTD 89 at 102-03.

Then in 1995, the Department presumed to create a new "bright line" "safe harbor" test, in Determination No. 93-269ER, 14 WTD 269 (1995), which purported to overrule 6 WTD 89 (and several other determinations) to the extent those determinations were inconsistent with its rationale. 14 WTD 269 at 277. The taxpayer in 14 WTD 269 was, like Simpson, a holding company that provided management services to its subsidiaries and also invested surplus cash and made intercompany loans to these affiliates. The Department, recognizing that this Court did not adopt a percentage test in either Sellen or Rainier, nevertheless presumed to rule that "... the Department of Revenue, as an administrative agency, will deem financial income of five percent or less of a taxpayer's annual gross income to be 'incidental,'" and not consider the taxpayer a "financial business" for purposes of the Section 4281 deduction. 14 WTD 269 at 275. The Department further indicated that "financial income" included all income from "loans and investments and the use of money as such" and only if a taxpayer's financial income exceeded the five percent would the Department reach the second inquiry

of whether the taxpayer's activities were similar to or comparable to, those of "banking, loan [or] security businesses." 14 WTD 269 at 275-76.

The Department followed its decision in Determination No. 93-269ER with the issuance of ETB 571.04.146/109. This bulletin was published by the Department on June 30, 1995 and has been cited by the Department as the primary authority for its determination that Simpson is a "financial business" and therefore not entitled to the Section 4281 deduction.²⁰ Apparently adopting the holding of Determination No. 93-269ER, the Department purports to create in ETB 571.04.146/109 a "bright line test" or "two-part inquiry" to determine whether a taxpayer is a financial business. Consistent with Determination No. 93-269ER, it first establishes the test that if a taxpayer's financial income is five percent or less of its annual gross receipts, the taxpayer will not be considered engaging in a financial business. If the taxpayer fails this first test, the

²⁰Simpson's claim for refund covers the period January 1, 1988, through May 31, 1996. ETB 571.04.146/109 was published near the end of this period. Assuming the legality and validity of Determination No. 93-269ER and subsequently ETB 571.04.146/109, which Simpson does not concede, it is apparent that most of the period for which Simpson is seeking a refund of the B&O taxes improperly paid is before the publication of ETB 571.04.146/109. Nothing in ETB 571.04.146/109 makes its provisions retroactive, but apparently it is the Department's position that it should be applied retroactively.

Department then moves to the second inquiry of whether the taxpayer's activities are similar to, or comparable to those of a banking, loan or security business. ETB 571.04.146/109, p. 1. ETB 571.04.146/109 further states that the second inquiry requires consideration of "the source of the income, frequency of investments, volume of investments, percentage of income from investments in relation to the total income of the business, and the relationship of the investment income to the other activities of the business." ETB 571.04.146/109, p. 1. In sum, ETB 571.04.146/109 attempts to create a so-called "bright line test" that is quite different from the test established eight years earlier in 4 WTD 341.²¹ Moreover, the "bright line test" creates a whole set of qualification and limitations not found in the language of the Section 4281 deduction. For example, there is nothing in the language of the deduction or its legislative history which limits either the dividends or investments to five percent of a company's gross income, or limits the frequency of investments or volume of investments; in fact, this Court specifically rejected a percentage requirement in both Sellen and Rainier. Rainier at 673, n.2.

²¹Notably, 4 WTD 341 was not included in the long list of determinations 14 WTD 269 listed as overruled. 14 WTD 269 at 277.

Neither the "test" nor "inquiry" are authorized by the legislature under the Section 4281 deduction, or Chapter 34.05 RCW, Washington's Administrative Procedure Act ("APA"). While the Department has the authority to adopt rules under the APA, it did not issue ETB 571.04.146/109 as a rule. Even though ETB 571.04.146/109, on its face, appears to fall either within the definition of an "interpretive statement as set forth in RCW 34.05.010(8), or a "policy statement" as defined in RCW 34.05.010(14), the APA's strict rule-making procedures required the bulletin to be adopted as a rule. By including strict rule-making requirements in the APA, the Legislature prohibited agencies from adopting directives affecting the public and businesses, thereby ensuring the public and businesses that they would have meaningful opportunities to comment and contest proposed agency actions. Here, the Department's excise tax bulletins are clearly directives of general applicability aimed at businesses and the public. The "bright line" and "safe harbor" tests imposed on businesses through these bulletins establish qualifications and requirements not found in the Section 4281 deduction. Moreover, if a business claims the deduction and fails to pay the B&O tax, the business is subject to severe tax penalties and other administrative sanctions. See RCW Chapter 82.32.

The Department's "bright line test," which has been imposed upon Simpson and all other businesses, thus falls within the APA's definition of a "rule" and as such, had to be adopted in accordance with the APA's rule-making procedures. Having failed to do so, the Department's bulletins, and the tests they impose, are invalid. "The remedy for failure to comply with applicable APA rule-making procedures is invalidation of the action." Faylor's Pharmacy v Department of Social and Health Services, 125 Wn.2d 488, 497, 886 P.2d 147 (1994).²² ETB 571.04.146/109 is neither an authorized adopted rule, nor is it consistent with the statute. This free-lance interpretive approach by state agencies is precisely the type of action the Legislature sought to curtail by the enactment of the strict rule-making procedures under the APA.

V.

CONCLUSION

Simpson is entitled to a deduction for its investment income under the Section 4281 deduction. This Court should reverse the judgment of

²²Even if the Department could successfully argue that its tax bulletins are interpretive or policy statements, which Simpson believes the Department cannot, the Department would still have been required to adopt these statements as rules unless it was not feasible or practicable to do so. See RCW 34.05.230(1).

the Superior Court, and mandate the entry of an order in favor of Simpson.

RESPECTFULLY SUBMITTED this 6th day of October, 1997.

LANE POWELL SPEARS LUBERSKY LLP

By Michael B. King
George C. Mastrodonato

WSBA No. 07483

Michael B. King

WSBA No. 14405

Kathleen D. Benedict

WSBA No. 07763

Attorneys for Appellant

SIMPSON INVESTMENT COMPANY

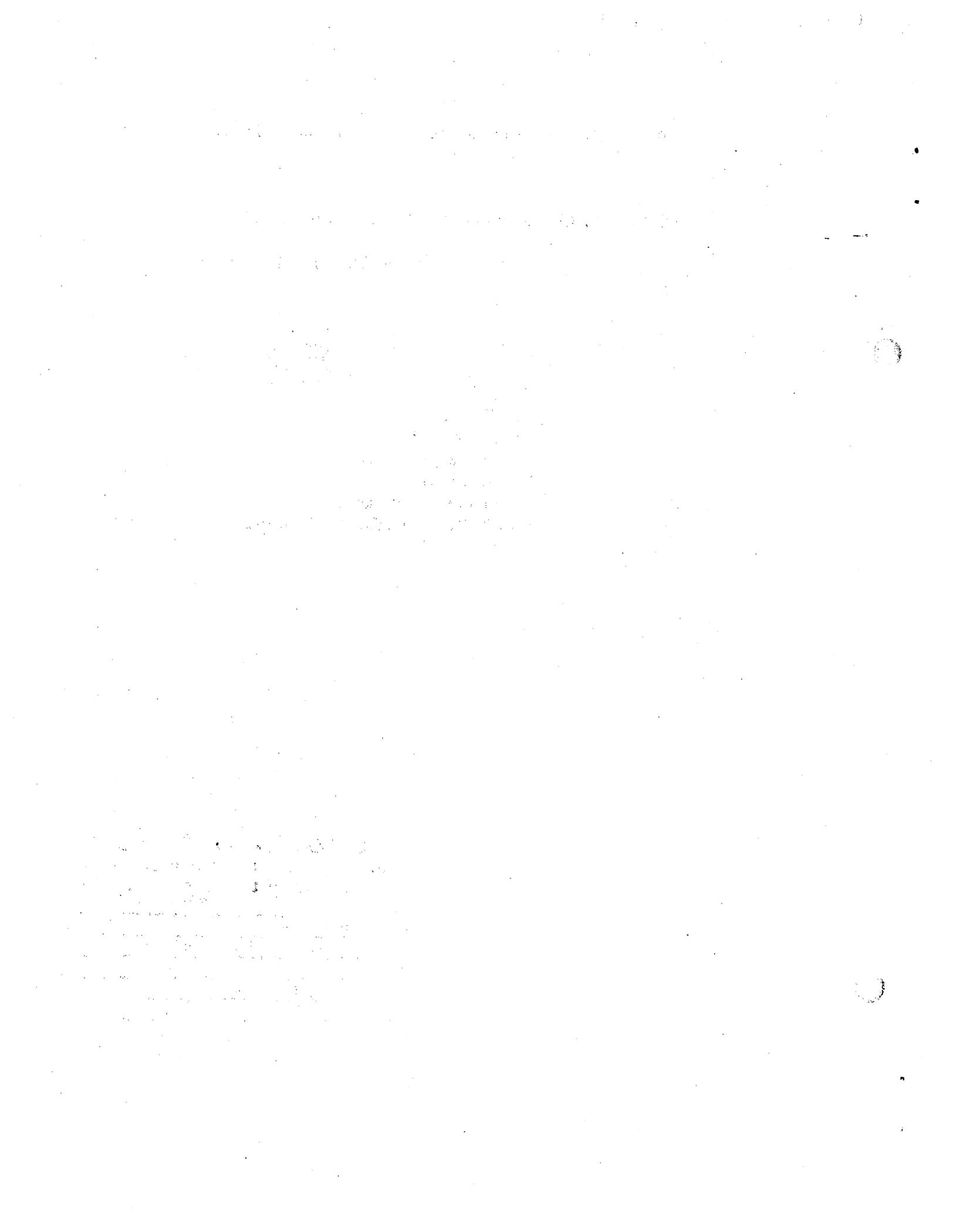
CERTIFICATE OF SERVICE

I hereby certify that a copy of this document was served via U.S. MAIL AT LAST KNOWN ADDRESS

On: JOHN S. BARNES
ATTORNEY GENERAL'S OFFICE

Date: OCTOBER 6, 1997

By: Michael B. King



APPENDIX B

67630-5

~~65394-1~~

SUPREME COURT
OF THE STATE OF WASHINGTON

SIMPSON INVESTMENT COMPANY,

Appellant

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Respondent

On Appeal from Thurston County Superior Court
Hon. Christine Pomeroy
No. 96-2-02386-5

RECEIVED
SUPREME COURT
STATE OF WASHINGTON
97 DEC 12 PM 4:52
BY C. J. HERRITZ
CLERK

BRIEF OF RESPONDENT

CHRISTINE O. GREGOIRE
Attorney General
JOHN S. BARNES, WSBA # 19657
Assistant Attorney General

Attorneys for Respondent
400 General Admin. Bldg.
P.O. Box 40123
Olympia, WA 98504-0123
(360) 753-5528

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. STATEMENT OF THE CASE	3
A. Procedural History of the Case	3
B. Overview of Simpson Investment Company	4
C. Simpson's Investment Income	5
III. ISSUES	9
IV. ARGUMENT	9
A. Introduction to B&O Tax	9
B. Simpson does not Qualify for the Section 4281 deduction Because Simpson is Engaging in Financial Business. And even if it isn't, Simpson would still be Ineligible to Take the Deduction for Interest Earned on its Investment of its Subsidiaries Surplus Funds Pursuant to its Cash Management System Because it would be Fee Income to Simpson	11
C. The Legislature did not Broaden the Section 4281 Deduction when It Amended the Rate Setting Sections of RCW 82.04.290 in 1993	14

D.	The Department's Determination that Simpson was Ineligible for the Section 4281 Deduction is Squarely on point with the Two State Supreme Court Cases Interpreting the Deduction	16
E.	The Department has never Determined that all Holding Companies are Financial Businesses for Purposes of the Section 4281 Deduction nor has the Department ever Determined that the Maintenance of a Cash Management System by a Parent Company Renders the Parent a Financial Business under the Statute	20
F.	The Department's Published Determinations have Consistently Held that if a Taxpayer Receives Value or Compensation for Coordinating a Cash Management System for the Benefit of its Subsidiaries, the Taxpayer is Engaging in Financial Business under the Statute	22
G.	The Department did not Violate the Rule-Making Provisions of the Administrative Procedures Act When it Promulgated ETB 571.04.146/109	28
V.	CONCLUSION	30

TABLE OF AUTHORITIES

<u>Cases</u>	<u>Page</u>
<i>American Sign & Indicator v. State</i> , 93 Wn.2d 427, 610 P.2d 353 (1980)	26
<i>Batterton v. Marshall</i> , 648 F.2d 694 (D.C. Cir 1980)	28
<i>Bennett v. Hardy</i> , 113 Wn.2d 912, 784 P.2d 1258 (1990)	29
<i>Brannan v. Department of Labor & Indus.</i> , 104 Wn.2d 55, 700 P.2d 1139 (1985)	28
<i>Budget Rent-A-Car, Inc. v. Department of Rev.</i> , 81 Wn.2d 171, 500 P.2d 764 (1972)	9, 11
<i>Federated American Inc., v. Marquardt</i> , 108 Wn.2d 651, 741 P.2d 18 (1987)	28
<i>Group Health Coop. of Puget Sound, Inc. v. State</i> <i>Tax Comm'n</i> , 72 Wn.2d 422, 433 P.2d 201 (1967)	11
<i>John H. Sellen Construction Company v.</i> <i>Department of Rev.</i> , 87 Wn.2d 878, 558 P.2d 1342 (1976)	passim
<i>Pac. N.W. Annual Conf. of the United Methodist Church</i> <i>v. Walla Walla Cy.</i> , 82 Wn.2d 138, 508 P.2d 1361 (1973)	11
<i>Rainier Bancorporation v. Department</i> <i>of Revenue</i> , 96 Wn.2d 669, 638 P.2d 575 (1982)	1, 17, 18, 19
<i>Rena-Ware Distribs., Inc. v. State</i> , 77 Wn.2d 514, 463 P.2d 622 (1970)	26

<i>Time Oil Co. v. State</i> , 79 Wn.2d 143, 483 P.2d 628 (1971)	9
<i>Winans v. W.A.S., Inc.</i> , 112 Wn.2d 529 722 P.2d 1001 (1989)	28

Statutes

RCW 82.04.055(2)(f)	14
RCW 82.04.220	9
RCW 82.04.290	4, 10, 14, 15
RCW 82.04.290(1)	9
RCW 82.04.290(2)	10
RCW 82.04.4281	passim
RCW 82.04.430(1)	1
RCW 82.32.300	28
Laws of 1993, Sp. Sess., ch. 25, § 203	10
Laws of 1993, Sp. Sess., ch. 25, § 201	15

MISCELLANEOUS

	<u>Page</u>
Determination No. 86-309A, 4 WTD 341 (1987)	23, 24
Determination No. 88-246, 6 WTD 89 (1988)	24

Determination No. 93-269ER, 14 WTD 269 (1995)	25
ETB 368.04.224	17
ETB 505.04.109, 2 ETB 309	22, 23
ETB 571.04.146/109	passim

I. INTRODUCTION

Appellant, Simpson Investment Company ("Simpson"), correctly states the issue before the court involves the interpretation and application of the business and occupation ("B&O") tax deduction statute, RCW 82.04.4281 (formerly 82.04.430(1)). Simpson Investment Company also correctly points out the deduction has twice been reviewed by this Court. *John H. Sellen Construction Company v. Department of Rev.*, 87 Wn.2d 878, 558 P.2d 1342 (1976) ("Sellen"); *Rainier Bancorporation v. Department of Rev.*, 96 Wn.2d 669, 638 P.2d 575 (1982) ("Rainier"). Simpson in its opening brief, however, misstates the Department's position regarding qualification for the deduction, then misstates and misapplies the case law to its erroneous interpretation of the Department's position. Therefore, it is necessary to clarify upfront the Department's interpretation of the deduction statute RCW 82.04.4281.

RCW 82.04.4281 allows a deduction from the measure of the B&O tax for amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such.¹ The deduction requires a taxpayer to meet a two part

¹RCW 82.04.4281 also provides a deduction from the measure of the B&O tax for dividends received from subsidiaries. This dividend income is not in dispute in the present action.

test. First, the taxpayer's investment income must be derived from "investments or the use of money as such". Second, the taxpayer cannot be engaging in a "banking, loan, security or other financial business".

Simpson is a Washington holding company operated as a corporation. Essentially, Simpson is seeking to exempt itself altogether from the B&O tax by excluding all its income from the measure of the B&O tax under RCW 82.04.4281. Primarily because Simpson generated all its revenue from investment sources, the Department determined Simpson to be a financial business and denied Simpson use of the deduction. Contrary to Simpson's assertion in its opening brief, the Department did not determine that all holding companies are financial businesses for purposes of the deduction, nor did the Department determine that the maintenance of a cash management system by a parent company renders the parent a financial business under the statute. The Department did, however, determine that Simpson's peculiar cash management system (Simpson keeps the interest earned on its investment of its subsidiaries excess funds), coupled with the fact Simpson earned no revenue from any nonfinancial activity made this particular holding company a financial business and ineligible for the deduction.

Because the Department found Simpson to be engaging in financial business, it did not consider whether the interest earned on Simpson's investment of its subsidiaries surplus funds was interest or fee income to Simpson. It is the Department's position that the investment interest is fee income to Simpson for its coordination of an elaborate cash management system for the benefit of its subsidiaries, and for the host of services it provides its subsidiaries for which it charges no fee.

II. STATEMENT OF THE CASE

A. Procedural History of the Case.

The Department of Revenue assessed Simpson \$137,420 in business and occupation ("B&O") tax under the "service and other activities" classification for the period January 1, 1988, through December 31, 1991. (CP 34-35). The tax was imposed on Simpson's revenues from interest, dividends, and other investment income. (CP 35). Between January 1, 1992, and May 31, 1996, Simpson paid an additional \$45,307 in B&O tax under the "service and other activities" or the "financial business services" classification on revenue from interest, dividends and other investment income. (CP 35-36). Simpson reported its B&O tax under the "service and other activities" classification for periods prior to July 1, 1993. *Id.* Thereafter, Simpson reported its B&O tax under the

"financial business services" classification resulting in Simpson paying tax at a lower rate.² *Id.* Simpson brought an action in Thurston County Superior Court to obtain a refund of B&O taxes paid. (CP 4-9). Simpson sought summary judgment claiming its income from interest, dividends, and other investment income qualifies for deduction from the measure of the B&O tax under RCW 82.04.4281. (CP 10). The Court (Hon. Christine Pomeroy) thought otherwise and granted summary judgment to the Department. (CP 291-92). Simpson now seeks direct review of this order by this Court. (CP 293-96).

B. Overview of Simpson Investment Company.

Simpson is a Washington corporation headquartered in Seattle, Washington. Simpson is the parent company of Simpson Timber Company and its subsidiaries, Simpson Paper Company and its subsidiaries, Simpson Extruded Plastics Company and its subsidiaries, and Simpson Foreign Sales Company. (CP 84). Simpson does not manufacture or produce a product for sale but, instead, provides centralized administrative services for the group. (CP 85). These services include Finance and Accounting, Credit, Human Resources,

²The Legislature amended RCW 82.04.290 in 1993, resulting in several new B&O reporting classifications. Simpson chose to report under the classification with the lowest rate—the financial business classification.

Legal, Management Information Services, Public Affairs, Risk, Tax and Treasury. *Id.* Simpson does not make direct inter-company charges for these services. *Id.*; (CP 158-166). Instead, Simpson indirectly receives payment for the services it provides its subsidiaries through the over-night interest it receives from its investment of its subsidiaries excess funds pursuant to an elaborate cash management system. (CP 85).

Simpson disputes the Department's assessment of B&O tax on Simpson's "investment income" consisting of the following: (a) interest earned on surplus subsidiary funds on deposit in Simpson Investment Company's bank accounts; (b) dividends received on a portfolio of stock that Simpson Investment Company holds in its publicly traded competitors in the timber, forest products, pulp and paper industries; (c) wood products market hedging and futures trading income; (d) minor amounts of interest earned from notes and contracts. (CP 7-8). The three major revenue sources are more fully described below.

C. Simpson's Investment Income.

Simpson operates an elaborate cash management system. (CP 94). Under Simpson's cash management system, each subsidiary maintains one or more deposit and disbursement accounts and Simpson maintains a concentration account. (CP 94-95). Funds are moved back and forth

between these entities or accounts on a daily basis. *Id.* The bank accounts maintained in the name of each Simpson subsidiary utilize a daily target zero account balance. (CP 95). The daily transfers of cash between the parent and subsidiary accounts determines the cash position for Simpson as well as all of the Simpson entities. *Id.* The movement of cash between bank accounts determines the consolidated borrowing requirements for the companies. *Id.* When one member of the family of related entities has excess funds in its checking account, these funds will be transferred to related entities having deficits before the deficit entity resorts to bank financing. (CP 94-95). The daily transfers of cash between the parent and subsidiary accounts may result in excess cash available for investment in Simpson's concentration account. (CP 95-96). This cash management system is coordinated by Simpson. (94-95).

Simpson has cash management systems in place at Seafirst Bank, Mellon Bank and Wells Fargo Bank. (CP 95). The cash management system is operated through a concentration account. *Id.* The concentration accounts at each of the above banks are operated by and are in the name of Simpson. *Id.* Deposits and disbursements from accounts maintained by subsidiary companies flow through the concentration accounts. *Id.* Deposits and disbursements to or from these concentration

accounts are recorded as accounts receivable or accounts payable on the subsidiaries books. (CP 167-189). Corresponding entries are made on the books of Simpson Investment Company. The daily transfers of cash between the parent and subsidiary accounts may result in excess cash available for investment in the concentration account. (CP 95-96). Simpson invests these account funds in overnight short-term deposits (CP 96). The interest earned on these overnight deposits is credited to Simpson and not its subsidiaries. (CP 95-96). The subsidiaries do not record or receive interest income from the overnight investment of their funds. (CP 167-189).

Simpson also receives dividend income from small amounts of stock it holds in its competitor companies. (CP 98). This portfolio of stock was acquired as a means of tracking what is happening with competitors and for obtaining financial information which is available to shareholders of those companies. *Id.* The Department imposed B&O tax on the cash dividends Simpson received from this portfolio of stock. (CP 34-36).

Lumber and plywood commodity price hedging was in operation at Simpson Investment Company from 1977 to April 1990. (CP 110). The purpose of the trading was to reduce the price volatility inherent in

the sale of lumber and plywood commodity items. (CP 111). The price hedge was accomplished by selling contracts for the future delivery of lumber on the Chicago Mercantile Exchange when those prices exceeded the corporate plan forecast or were higher than regular customers were willing to pay at the time. *Id.* When the expiration date for the futures contract approached, the contract was closed-out and an equal volume of lumber was sold to Simpson's normal customers at the market price. *Id.* If commodity price levels had fallen since the date of the original futures contract sale, then there would be a profit from the futures contract. *Id.* If market prices had risen since the sale of the futures contract, a loss would be recorded. *Id.* The gains and losses from the futures contracts were accumulated in one ledger account for financial control purposes. *Id.* The Department assessed B&O tax on the income generated from these price hedging activities. (CP 34-36).

The vast majority of Simpson's investment income is derived from dividends it receives from its holdings in its subsidiaries stock. Considering the investment activities described above and factoring in dividends from subsidiaries, (plus minor amounts of interest earned from notes and contracts) Simpson derives most, if not all, of its income from investment sources. (CP 158-166).

III. ISSUES

A. Whether Simpson is a financial business and thus excluded from taking a deduction from the measure of its B&O tax for its investment income?

B. Whether the interest Simpson earns from investment of its subsidiaries surplus funds is compensation to Simpson for its cash management activities, or an indirect fee for administrative services Simpson provides to its subsidiaries for which it charges no fee?

IV. ARGUMENT

A. Introduction to B&O Tax.

RCW 82.04.220 imposes the B&O tax on every person "for the act or privilege of engaging in business activities." The Legislature's intent was to adopt a taxing scheme that applied to "virtually all business," *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971), and left "practically no business or commerce" free of the tax. *Budget Rent-A-Car, Inc. v. Department of Rev.*, 81 Wn.2d 171, 175 500 P.2d 764 (1972). The tax is measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business.

Prior to July 1, 1993, RCW 82.04.290(1) specified that, as to persons engaging in business within this state in any business activity

other than, or in addition to, those enumerated in other sections of the law (e.g., extracting, manufacturing, retailing, wholesaling, etc.), the "service and other activities" B&O tax was to be imposed on the gross income of such business. The "service and other activities" B&O tax applied to, among other revenue sources, interest, dividends and similar investment income.

The Legislature amended RCW 82.04.290 in 1993, changing the B&O tax reporting classification for financial businesses. Effective July 1, 1993, RCW 82.04.290(2) imposes B&O tax on a financial business's investment income under the "financial business services" classification. See Laws of 1993, Sp. Sess., ch. 25, § 203. The "financial business services" B&O tax applies to every person engaging in this state in banking, loan, security, investment management, investment advisory, or other financial businesses. RCW 82.04.290(2). Simpson has been reporting its investment activity income under this classification since July 1, 1993. Not surprisingly, the B&O tax rate for the financial businesses classification was 1.7 percent compared to 2.0 and 2.5 percent for other selected business service classifications under which Simpson could have, or should have, been reporting.

B. Simpson does not Qualify for the Section 4281 deduction Because Simpson is Engaging in Financial Business. And even if it isn't, Simpson would still be Ineligible to Take the Deduction for Interest Earned on its Investment of its Subsidiaries Surplus Funds Pursuant to its Cash Management System Because it would be Fee Income to Simpson .

The Legislature has granted several narrow deductions and exemptions from the B&O tax. Regarding exemptions and deductions *Group Health Coop. of Puget Sound, Inc. v. State Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967) states:

In connection with each, the burden of showing qualification for the tax benefit afforded likewise rests with the taxpayer. And, statutes which provide for either are, in case of doubt or ambiguity, to be construed strictly, though fairly and in keeping with the ordinary meaning of their language *against the taxpayer*.

(Emphasis supplied).

See also *Budget Rent-a-Car of Washington-Oregon, Inc. v. Department of Rev.*, 81 Wn.2d 171, 175, 500 P.2d 764 (1972) ("Taxation is the rule and exemption is the exception.") To strictly construe a statute simply means that given a choice between a narrow, restrictive construction and a broad, more liberal interpretation, the narrow, restrictive construction must be used. *Pac. N.W. Annual Conf. of the United Methodist Church v. Walla Walla Cy.*, 82 Wn.2d 138, 141, 508 P.2d 1361 (1973). Based on the

facts of this case a narrow but fair construction of RCW 82.04.4281 would preclude the exemption to Simpson.

While Simpson does not hesitate to report its income under the low B&O rates of the financial business classification, it denies it engages in financial business, given almost identical language, where to do so would disqualify it from the deduction found in RCW 82.04.4281. Essentially, Simpson is seeking to exempt itself altogether from the B&O tax by excluding all its income from the measure of the B&O tax under RCW 82.04.4281. RCW 82.04.4281 provides:

In computing tax there may be deducted from the measure of the tax amounts derived by persons, other than those engaging in banking, loan, security, or other *financial businesses*, from investments or the use of money as such, and also amounts derived as dividends by a parent from its subsidiary corporations.

(Emphasis supplied.)³

The deduction requires a taxpayer to meet a two part test. First, the taxpayer cannot be engaging in "banking, loan, security or other financial businesses." Second, the taxpayer's investment income must be derived from "investments or the use of money as such". Simpson fails

³Simpson earns the overwhelming majority of its revenues from dividends received from its subsidiaries. This dividend income is not in dispute in the present action.

both parts of the test. First, Simpson is engaged in financial business notwithstanding its erroneous claim it is in the forest products business. While its true Simpson does provide administrative services for its subsidiaries, who are themselves in the forest products business, Simpson does not produce or manufacture a single forest product and does not derive any revenue from services provided to subsidiaries. However, Simpson does specialize in the handling and investment of funds. A regular and substantial part of Simpson's normal business practice involves investing its subsidiaries surplus funds, investing in its competitor's stock, and commodity price hedging. In fact, if this Court was to find the interest received on the overnight deposits is investment income to Simpson, then fully 100% of Simpson's revenue is derived from investments and Simpson could be nothing but a financial business.

Second, the interest earned on Simpson's overnight investment of its subsidiaries' surplus funds pursuant to its cash management activities is not investment income to Simpson. The interest received by Simpson from investing its subsidiaries funds, and erroneously reported by Simpson as interest income, is really either compensation for its money management activities, or compensation for services (finance and accounting, credit, human resources, legal, management information

services, public affairs, risk, tax and treasury) Simpson provides to its subsidiaries for which it does not charge. Either way Simpson is not entitled to the Section 4281 deduction. More importantly, if the interest is actually compensation for Simpson's cash management services or compensation for administrative services provided subsidiaries, then Simpson is reporting under the wrong B&O tax classification and owes substantial additional tax.

C. **The Legislature did not Broaden the Section 4281 Deduction when It Amended the Rate Setting Sections of RCW 82.04.290 in 1993.**

Simpson places great weight on the Legislature's amendment of RCW 82.04.290. Simpson's reliance is without merit. In 1993, the Legislature simply broke down the "Services and Other Activities" B&O tax classification into subsections each with its own rate. Contrary to Simpson's opening brief, (App. Brief at 3-4) the Legislature did not at the same time amend RCW 82.04.4281, and certainly did not intend to broaden the exemption by narrowing the types of financial businesses who previously failed to qualify for the exemption.

Equally without merit, is Simpson's unsupported assertion that in 1993 when the Legislature acted to define the terms "financial institution" and "financial services" in RCW 82.04.055(2)(f) it also intended to

confirm the scope of the related term "financial business" in RCW 82.04.4281. See Laws of 1993, Spec. Sess. ch. 25 § 201. If the Legislature wanted to broaden the scope of the exemption, it could have easily done so. The Legislature's classification of businesses in the rate setting section of RCW 82.04.290 has absolutely no bearing on the exemption statute RCW 82.04.4281. RCW 82.04.4281 stands alone. Moreover, the Legislature's definition of the terms "financial institution" and "financial services" only pertain to activities associated with banks or savings and loan associations. Many types of financial businesses such as check cashing services and pawn shops as well as insurance companies and investment companies which the state's highest court has determined to be ineligible for the Section 4281 deduction are excluded from the definitions. See *John H. Sellen Construction Company v. Department of Revenue*, 87 Wn.2d 878, 558 P.2d 1342 (1976). A much more likely explanation for the non-inclusion of these types of financial businesses under the definition of "financial institutions" and "financial services" is that these types of businesses are taxed at the higher "business services" B&O rate then the rate for financial institutions and financial service companies.

D. The Department's Determination that Simpson was Ineligible for the Section 4281 Deduction is Squarely on point with the Two State Supreme Court Cases Interpreting the Deduction.

The Department's interpretation of RCW 82.04.4281 with respect to Simpson is squarely on point with the two State Supreme Court cases interpreting the deduction. In *Sellen* a general contractor, a brewer, a medical and health care service provider and a trust fund for the care and upkeep of cemetery grounds brought refund actions against the Department. These taxpayers contested the imposition of B&O tax on their investment income from time certificates, commercial paper, repurchase agreements, commercial discount notes, corporate bonds, savings deposits, stocks, bonds, and real estate notes and mortgages. The Supreme Court noted that the term financial business is not defined in the statute. The Court afforded the term its plain and ordinary meaning. Giving the term financial business its common meaning the Court defined the phrase as contemplating a business whose primary purpose and objective is to earn income through the utilization of significant cash outlays. The Court also looked to the dictionary definition of the term "financial institution" for guidance. Webster's

Third New International Dictionary (1968) defined a "financial institution"

as:

[A]n enterprise specializing in the handling and investment of funds (as a bank, trust company, insurance company, savings and loan association, or investment company).

Sellen at 883.

The Court, however, did not equate the term "financial business" with the term "financial institution" as erroneously asserted by Simpson.⁴ (App. Brief at 27). The Court found that the taxpayers derived only a very small percentage of their total gross revenues from investment activities, (less than three percent) and earned substantial income from non-financial activities. The Court then concluded that the *Sellen* taxpayers' businesses were not similar to banking, loan, or security businesses. That is not the case here. Simpson specializes in the handling and investment of funds. It is a regular part of Simpson's normal business practice.⁵ Simpson earns no income from non-financial activities, and all

⁴Years later when the state supreme court was faced with interpreting this same deduction, it started its analysis by noting that in deciding *Sellen*, it declined to conclusively define the term "financial business". *Rainier Bancorporation v. Revenue*, 96 Wn.2d 669, 638 P.2d 575 (1982).

⁵The *Sellen* Court cited with approval the Department's position in State Department of Rev, Excise Tax Bull., No. 368.04.224 (June 12, 1970) where the Department said: But it does not follow that every act of business or every investment and grant of the use of money is held to be financial business...Where the activities involved are essentially in competition with financial businesses and this is a regular part of the taxpayer's normal business

Simpson's revenues are from investment sources. This makes Simpson engaging in a financial business and ineligible for the deduction. Consistent with this interpretation, Simpson has been reporting to the state under the financial services B&O tax classification.

The state Supreme Court was given another opportunity to construe RCW 82.04.4281 in *Rainier Bancorporation v. Revenue*, 96 Wn.2d 669, 638 P.2d 575 (1982). Rainier Bancorporation was the holding company for Rainier Bank, Rainier Mortgage Company, and Rainier Credit Company. Rainier's business activities consisted of the receipt of dividends and interest from some marketable securities which were in the process of being liquidated, gains on the sale of securities and interest received from its subsidiaries for financing in the form of equitable capital, loans and advances. Rainier earned 100% of its revenues from investment sources. The Court, concluded Rainier Bancorporation was engaged in financial business, although technically, Rainier did not fall within a specific definition of a banking, loan, or security business. Noting that tax deductions are to be narrowly construed, the Court concluded Rainier was ineligible for the benefit of the deduction since

practice, the department believes that the activities constitute financial business and are subject to tax.
Sellen at 884.

Rainier earned all its revenues from investment sources and by making loans to its subsidiaries its activities were, nevertheless, similar or comparable to that of a banking, loan or security business.

Likewise, Simpson is ineligible to deduct its investment income. First, Simpson like Rainier derives all its income from investment sources. While this fact is not determinative of whether Simpson is prohibited from taking the deduction, (neither the *Sellen* Court or the *Rainier* Court adopted a percentage test) it is a strong indication that Simpson engages in financial business. Second, Simpson like Rainier Bancorporation derives interest income from its investment of funds obtained from outside sources. Simpson invests its subsidiaries surplus funds in short-term overnight deposits and records the earned interest on its own books.⁶ Finally, Simpson like Rainier specializes in the handling and investment of funds; Simpson in its operation and management of its elaborate cash management system for its subsidiaries. Because these activities are

⁶ The *Rainier* Court limited its decision to holding companies, such as Rainier, which are engaged in a "financial business". Simpson erroneously asserts in its opening brief that it is unlike the taxpayer in *Rainier* (a financial business) because it makes loans solely out of its own surplus funds. (App. Brief at 33). This is not the case. Simpson makes loans to its subsidiaries from its subsidiaries surplus funds as well as from its own funds. (CP 94-95). The Court ventured no opinion on the question of whether a holding company that makes loans *solely* out of its own surplus funds is subject to the B&O tax. *Rainier* at 674.

regular and substantial, they are similar or comparable to the activities of a financial business. In fact, if Simpson did not undertake its elaborate cash management system, its subsidiaries would conceivably have to obtain operating funds from a bank or other financial institution. In this regard, Simpson would be in competition with a bank. Under these circumstances, Simpson is engaging in financial business for purposes of RCW 82.04.4281.

E. **The Department has never Determined that all Holding Companies are Financial Businesses for Purposes of the Section 4281 Deduction nor has the Department ever Determined that the Maintenance of a Cash Management System by a Parent Company Renders the Parent a Financial Business under the Statute.**

Contrary to Simpson's assertion, the Department did not determine that all holding companies are financial businesses for purposes of the deduction. (App. Brief at 33). The Department did determine that Simpson (a holding company) was engaging in financial business. The Department relied on the fact that Simpson earned all of its revenues from investment sources. In this regard, Simpson is a lot like Rainier Bancorporation which this state's highest court has determined to be a financial business holding company. Simpson's analysis of how other jurisdictions have treated holding companies is irrelevant to whether

Simpson is a financial business under RCW 82.04.4281. Whether a holding company is to be treated as a "financial business" depends on the legislative enactment and the case law of the particular jurisdiction. Comparing how other jurisdictions have treated holding companies, to how the Department treats financial holding companies like Simpson is comparing apples and oranges. The taxing statutes cited are so dissimilar that comparing them is fruitless.

Likewise, the Department has not determined that the maintenance of a cash management system by a parent company renders the parent a financial business under the statute as Simpson asserts. (App. Brief at 42). The cash management system utilized by Simpson is atypical of the structure and system used by most major corporations in this state and elsewhere. What makes Simpson's cash management system so atypical is that Simpson keeps the interest earned on its investment of its subsidiaries surplus funds. In actuality, the interest is either a fee for coordinating the cash management system or an indirect fee for the host of services Simpson provides its subsidiaries for which it charges no fee. In either case, the interest is fee income to Simpson. Under the circumstances, the income received was not for the "use of money as such" and not subject to exemption under RCW 82.04.4281. Simpson's

claim for exemption under RCW 82.04.4281 is just an awkward attempt at avoiding all B&O tax.⁷

F. **The Department's Published Determinations have Consistently Held that if a Taxpayer Receives Value or Compensation for Coordinating a Cash Management System for the Benefit of its Subsidiaries, the Taxpayer is Engaging in Financial Business under the Statute.**

Realizing the Supreme Court's definition of a financial business does not give the average taxpayer much guidance in determining if it is a financial business for purposes of RCW 82.04.4281, or whether its investment income is incidental to its nonfinancial activities, the Department has issued a series of determinations. The first of these determinations was ETB 505.04.109, 2 ETB 309, dated March 4, 1977.

ETB 505.04.109 merely reiterated the holding of *Sellen* stating:

The Court did not define "investments" in its opinion. However, it noted that enterprises "specializing in the handling and investment of funds" would not be entitled to the statutory deduction but that those "making incidental investment of surplus funds" should receive the deduction.

Under the holding of the Court in *Sellen*, income from the incidental investment of surplus or excess funds by persons who are not themselves in a security, investment, or financial business is not subject to tax.

⁷If a Simpson utilized a cash management system whereby the interest earned on its subsidiaries surplus funds were credited to its subsidiaries, the Department would not have determined Simpson was engaged in financial business.

Because ETB 505.04.109 merely reiterated the holding in *Sellen*, it did not prove helpful to taxpayers. However, as has been previously shown, under *Sellen Simpson* is engaging in financial business and not entitled to the benefit of the deduction.

Following the issuance of ETB 505.04.109, the Department considered a cash management system whereby the taxpayer provided operating funds and collected operating income from its subsidiaries on a daily basis. Determination No. 86-309A, 4 WTD 341 (1987). In 4 WTD 341 the taxpayers system consisted of a network of banking accounts through which the taxpayer would "clean sweep" all the subsidiary accounts on a daily basis to manage the flow of corporate funds. The taxpayer did not invest its subsidiaries funds overnight in short-term deposits. No actual loans were transacted and no notes or other evidences of any indebtedness were executed. The taxpayer imputed an interest rate on the disbursements it made to its subsidiaries and booked the interest as an internal cost accounting control. The taxpayer received no actual payments of interest from its subsidiaries and no interest was actually earned. The taxpayer booked the imputed interest for use as a measuring method to determine the efficiency of its subsidiaries use of operating funds. Under the circumstances the Department determined that the

imputed interest was not subject to B&O tax since no value accrued to the taxpayer and no interest was actually paid. Because Simpson actually received the interest from the overnight investment of its subsidiaries surplus funds, 4 WTD 341 is easily distinguishable from the present case. Simpson's reliance on 4 WTD 341 for support of its own exclusion from B&O tax is insupportable considering that Simpson actually received interest income from its investment of its subsidiaries surplus funds.

Likewise, Determination No. 88-246, 6 WTD 89 (1988) does not support Simpson's case for exclusion of its investment income. In 6 WTD 89, the Department held that interest income derived from a parent company's regular and recurrent loans to its subsidiaries evidenced by interest bearing notes was not deductible under the Section 4281 deduction. The Department noted, however, that borrowing by a parent company in order to provide the operating revenues to its subsidiaries, whereby the parent company acts merely as a conduit or pass-through mechanism so that subsidiaries could receive loan proceeds from third party sources on the parent company's line of bank credit, does not subject the parent to B&O tax on the interest income paid to the parent by the subsidiary and immediately forwarded to the third party lender.

Realizing a great amount of taxpayer confusion still existed surrounding whether a taxpayer was engaged in financial business for purposes of RCW 82.04.4281, and whether its investment income was incidental to its nonfinancial activities, the Department created a "bright line" or "safe harbor" test in Determination No. 93-269ER, 14 WTD 269 (1995). Determination No. 93-269ER overruled all previous determinations inconsistent with its rationale. The Department immediately followed its decision in Determination No. 93-269ER with the issuance of ETB 571.04.146/109 (ETB 571), issued June 30, 1995.

Under both Determination No. 93-269ER and ETB 571 a two-part inquiry is used to determine if a taxpayer is a financial business.

Regarding the first inquiry, the ETB provides:

The first inquiry requires determining whether the primary purpose and objective of the taxpayer is to earn income through the utilization of significant cash outlays or whether these activities are merely "incidental" to the taxpayer's nonfinancial business activities. This inquiry is made by applying a percentage test. The Department conclusively presumes that the income is not from engaging in a financial business, but is incidental to the nonfinancial business activities, if the financial income is five percent or less of the annual gross receipts. The percentage of financial income will be computed by including all calendar or fiscal year financial income from "loans and investments or the use of money as such" in the numerator, whether taxable, exempt, or deductible, and including all calendar or fiscal year revenues as normally measured by the B&O

tax, including all revenues otherwise exempt or deductible, in the denominator.

If the first inquiry results in five percent or less of financial income in each of the years, it is unnecessary to proceed to the second inquiry. The taxpayer will not be considered as engaging in a "financial business". If the percentage exceeds five percent in any of the years, it is necessary to proceed with the second inquiry, but only for those years in which the percentage exceeds five percent.

In determining the relative significance of investment earnings compared to a taxpayer's nonfinancial earnings in order to satisfy the first inquiry of ETB 571, a holding company may not include the revenue of separate affiliates in its percentage calculation. The tax liability of a corporation must be considered without regard to its relationship to a parent or subsidiary company or to the existence of common officers, employees, facilities, or stock ownership. *American Sign & Indicator v. State*, 93 Wn.2d 427, 429, 610 P.2d 353 (1980) citing *Rena-Ware Distributions, Inc. v. State*, 77 Wn.2d 514, 463 P.2d 622 (1970).

Considering Simpson Investment Company apart from its subsidiaries, Simpson Investment Company does not meet the first test of ETB 571 requiring its investment income be less than 5% of its total income. Simpson Investment Company's investment income is not

incidental to its earnings from other activities. In fact, all of Simpson Investment Company's income is investment income.⁸

ETB 571 provides a second test if the first test is not met:

The second inquiry for determining when a taxpayer's activities constitute a "financial business" involves whether the taxpayer's activities are similar to, or comparable to, those of "banking, loan [or] security businesses", even though the taxpayer might not technically fall within one of those three categories. The factors which will be considered include, but are not limited to, the source of the income, frequency of investments, volume of investments, percentage of income from investments in relation to the total income of the business, and the relationship of the investment income to the other activities of the business.

Simpson Investment Company invests all the money swept from its subsidiaries' accounts nightly. This activity is both regular and substantial. This income and dividend income from subsidiaries and its holdings in competitor's stock constitute most, if not all, of Simpson Investment Company's income. Since Simpson Investment Company does not manufacture or produce a single product or receive compensation for services provided to its subsidiaries, Simpson Investment Company is

⁸While dividend income of a parent from its subsidiaries is exempt under RCW 82.04.4281, that exempt dividend income is investment income and should be included when computing the percentage for the purpose of ETB 571. Factoring in dividends from subsidiaries, Simpson Investment Company derives over 99% of its revenue from investment sources.

engaging in financial business and is precluded from taking a deduction under RCW 82.04.4281.

G. The Department did not Violate the Rule-Making Provisions of the Administrative Procedures Act when it Promulgated ETB 571.04.146/109.

An agency has inherent authority to adopt interpretive rules and may adopt legislative rules if authority is so delegated by the Legislature. Only legislative rules have the force of law and require APA notice and comment procedures for their promulgation. *Batterton v. Marshall*, 648 F.2d 694 (D.C. Cir 1980). Interpretive rules can be persuasive to a court upon review, but do not have the force of law. *Winans v. W.A.S., Inc.*, 112 Wn.2d 529, 722 P.2d 1001 (1989). The legislature has expressly granted the Department rule-making authority for the purpose of interpreting and carrying out Washington tax statutes. RCW 82.32.300. Rules adopted by an agency expressly authorized to interpret and carry out a statute are presumed valid. *Federated American Inc., v Marquardt*, 108 Wn.2d 651, 654, 741 P.2d 18 (1987). The burden of overcoming this presumption lies on the challenger. *Brannan v. Department of Labor & Indus.*, 104 Wn.2d 55, 60, 700 P.2d 1139 (1985).

Simpson alleges the "bright line" test delineated in ETB 571 creates a whole set of qualifications and limitations not found in the

language of the Section 4281 deduction. This argument is without merit for numerous reasons. First, neither the Department's opinion interpreting a statute, nor a rule properly adopted by the Department carries the force of law or is binding upon a court interpreting a statute. Second, procedural due process rights (notice and an opportunity to be heard) must only be afforded a taxpayer before a regulation of general applicability the violation of which subjects a person to a penalty or administrative sanction may be imposed. Here, Simpson has not violated any regulation. Nor has the Department subjected Simpson to a penalty or administrative sanction merely by denying Simpson use of the Section 4281 deduction and subjecting Simpson's investment income to the measure of the B&O tax.

Finally, in interpreting a statute, great weight must be accorded to the contemporaneous construction placed upon it by officials charged with its enforcement, particularly where that construction has been accompanied by silent acquiescence of the legislative body over a long period of time. *Bennett v. Hardy*, 113 Wn.2d 912, 928, 784 P.2d 1258 (1990). Here, the principal agency charged with interpreting Washington tax statutes is the Department and its interpretation of the Section 4281

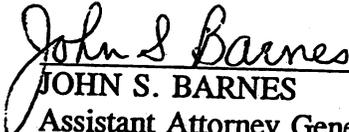
deduction is entitled great weight even if ETB 571 is not a properly adopted rule.

V. CONCLUSION

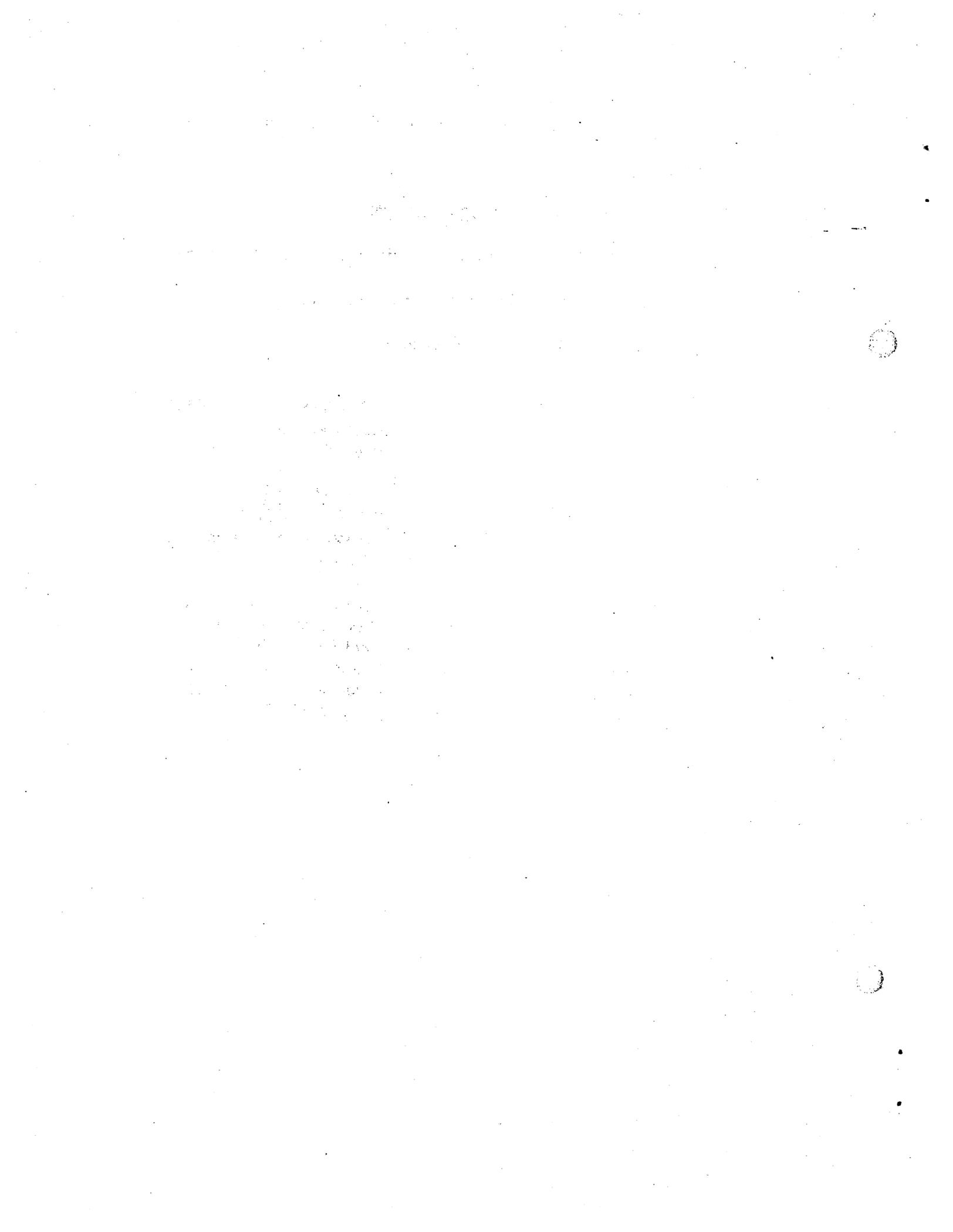
For the reasons mentioned above, this Court should affirm the trial court's denial of a RCW 82.04.4281 deduction to Simpson.

DATED this 12 th day of December, 1997.

CHRISTINE O. GREGOIRE
Attorney General
State of Washington


JOHN S. BARNES
Assistant Attorney General
WSBA # 19657

Attorneys for Washington
Department of Revenue
400 General Admin. Bldg.
P O Box 40123
Olympia WA 98504-0123
(360) 753-5528



APPENDIX C

07630-5
22907-2
No. 65394-1

SUPREME COURT
OF THE STATE OF WASHINGTON

SIMPSON INVESTMENT COMPANY,

Appellant

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent

Appeal From Thurston County Superior Court
Honorable Christine A. Pomeroy

APPELLANT'S REPLY BRIEF

George C. Mastrodonato
WSBA No. 07483
Kathleen D. Benedict
WSBA No. 07763
Michael B. King
WSBA No. 14405
LANE POWELL SPEARS LUBERSKY LLP
Attorneys for Appellant
Simpson Investment Company

Lane Powell Spears Lubersky LLP
2120 Caton Way S.W., Suite B
Olympia, Washington 98501-1105
Telephone: (360) 754-6001
Facsimile: (360) 754-1605

COURT FILED
DIVISION II
FEB 26 AM 10:00
BY _____
STATE OF WASHINGTON
CLERK

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES	iii
I. SUMMARY OF REPLY	1
II. ARGUMENT ON REPLY	2
A. Simpson Has Consistently Taken the Position It Is Not a Financial Business	2
B. Simpson Is a Parent Holding Company Engaged (Along With Its Subsidiaries) in the Forest Products Business; the Department's Contrary Claim Would Effectively Deny the Benefits of the Section 4281 Deduction to Any Business Conducted Through a Parent-Subsidiary Corporate Structure	4
C. This Court, in <u>John H. Sellen Construction Company v. Department of Revenue</u> , Defined a "Financial Business" as One Whose Primary Purpose and Objective Is to Earn Income Through the Utilization of Significant Cash Outlays; Simpson Plainly Is <u>Not</u> a Financial Business Under This Approach	9
D. This Court's Holding in <u>Rainier Bancorporation v. Department of Revenue</u> Does Not Apply to Nonmoneyed Holding Companies Like Simpson	12
E. In 1993, the Legislature Defined "Financial Institution" Consistent With This Court's Decisions in <u>Sellen</u> and <u>Rainier</u> ; the Department's Arguments About "Expanding" the Scope of the Exemption Are Wholly Irrelevant (or Not on Point)	13
F. Simpson's Use of a Cash Management System Does Not Make It a Financial Business; the Department's Contrary Claim Is Based on a Mischaracterization of the Actual and Undisputed Facts Found in the Record in This Case	15

G. Simpson, as a Parent Holding Company, Provides Common Administrative Services at No Cost to Its Subsidiaries; the Department's Contrary Claim Is Unsupported by the Record and Constitutes a Wholly Improper Attempt to Repudiate on Appeal What the Department Conceded During the Audit Process 18

H. The Department's Own Determinations Do Not Support Its Present Claim That Simpson Is a Financial Business, and Its Recent Attempt to Evade Those Determinations by Promulgating a New "Bright Line" Rule (ETB 571) Is an Evasion of This Court's Controlling Decisions and a Violation of the Administrative Procedures Act 20

III. CONCLUSION 25

TABLE OF AUTHORITIES

Page

CASES

<u>Ashenbrenner v. Department of Labor and Industries</u> , 62 Wn.2d 22, 380 P.2d 730 (1963)	14
<u>John H. Sellen Construction Company v. Department of Revenue</u> , 87 Wn.2d 878, 558 P.2d 1342 (1976)	1, 2, 9, 10, 11, 13, 14, 15, 23, 24
<u>North American Co. v. Securities & Exchange Comm'n</u> , 327 U.S. 686, 90 L. Ed. 945, 66 S. Ct. 785 (1946)	6
<u>Rainier Bancorporation v. Department of Revenue</u> , 96 Wn.2d 669, 638 P.2d 575 (1982)	1, 2, 12, 15, 23, 24
<u>Sacred Heart Medical Center v. Department of Revenue</u> , 88 Wn. App. 632, 946 P.2d 409 (Div. II 1997)	4
<u>University of Washington v. Jacobs</u> , 68 Wn. App. 44, 842 P.2d 971 (1992), <u>rev. denied</u> , 121 Wn.2d 1018, 854 P.2d 41 (1993)	15

STATUTES AND COURT RULES

RCW Chapter 34.05	23
RCW 82.04.055	13
RCW 82.04.290	4, 13, 15
RCW 82.04.290(2)	2
RCW 82.04.310 through 4332	4
RCW 82.04.430	9
RCW 82.04.4281	passim

RCW 82.32.050	3
RCW 82.32.090	3
RCW 82.32.180	3
RCW 82.32.410	20
Laws of 1993, Spec. Sess, ch. 25 § 201(f)	14
Laws of 1993, 1st Spec. Sess., ch. 25 § 203(2)	13
RAP 9.11	20

MISCELLANEOUS

<u>Fletcher Cyclopeda of Corporations, § 2821</u> (perm. ed. 1997)	6
ETB 571.04.146/109	2, 6, 8, 9, 20, 23, 24
4 WTD 341	20, 21, 22
6 WTD 89	22
14 WTD 269	8, 23

I.

SUMMARY OF REPLY

The Department's case for affirmance is tantamount to a call for the judicial evisceration of the Section 4281 deduction:

- First, while ostensibly conceding that the dividends paid to a parent holding company are exempt from B&O taxation, the Department proceeds to include those dividends in a calculation that the Department claims proves Simpson is a financial business. According to the Department, Simpson's investment income constitutes over 95 percent of its income, and Simpson therefore is a "financial business" for purposes of Section 4281. But the Department can only arrive at its imposing percentage by including the very dividends that the Legislature has exempted from taxation under Section 4281. By the Department's logic, every parent holding company becomes a financial business -- a result unsupported by case law, as well as the plain language of Section 4281.

- Second, while ostensibly honoring this Court's decisions in John H. Sellen Construction Company v. Department of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976), and Rainier Bancorporation v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982), the Department actually revives claims expressly rejected by those decisions. Once the Department's improper attempt to include exempt dividend income has been corrected, one recognizes that Simpson's actual investment income totals only 2.6 percent. In Sellen, this Court expressly held that such incidental investment earnings did not transform a

nonfinancial business into a financial one. To affirm the Superior Court in this case effectively requires this Court to overrule Sellen -- and the Department has not even tried to argue for such a course.

- Third, and perhaps most disturbing, the Department invokes the putative authority of a "bright line" test -- ETB 571.04.146/109 -- that conflicts with Sellen and Rainier, and was promulgated in violation of our state's Administrative Procedures Act. Virtually conceding these points, the Department claims this Court should still defer to ETB 571's bright line approach -- because, the Department says, it is "entitled" to such deference. The Department is wrong, and this Court should disabuse the tax collection authority of our state of the profoundly dangerous notion that it is above the law.

II.

ARGUMENT ON REPLY

A. Simpson Has Consistently Taken the Position It Is Not a Financial Business.

The Department paints Simpson as attempting to evade its tax responsibilities by implying that Simpson has tried to avoid paying all B&O taxes. The Department states that Simpson argues it is not a financial business for purposes of the deduction under RCW 82.04.4281 (the "Section 4281 deduction"), while simultaneously claiming it is a financial business in order to receive the benefit of the lower B&O tax rate under RCW 82.04.290(2). See Brief of Respondent at 9-10. This characterization ignores the effect of the very Department actions at issue in this case.

Prior to 1993, Simpson did not pay B&O tax on any of the income that is the subject of this case. Following the Department's 1989-1992 audit, the Department issued an audit report asserting Simpson was a "financial business" and therefore ineligible for the Section 4281 deduction. (CP 280-81.) Simpson appealed the Department's determination, but was required to file monthly tax returns during the course of the appeal. If Simpson continued to claim the Section 4281 deduction on these returns, and the courts upheld the Department's position, Simpson would then have owed B&O tax, plus interest (see RCW 82.32.050) and possibly penalties (see RCW 82.32.090) for all the intervening years between the end of the audit period and final resolution of Simpson's challenge to the audit.

Thus, during the pendency of this litigation, Simpson chose to pay B&O tax in accordance with the Department's disputed characterization, as the income was earned and liability accrued, but did so only to avoid the Department's assessment of interest and penalties on any unpaid liability.¹ Despite the insinuations made in the Department's brief, the record clearly reflects that Simpson has at all times disputed and continued to pursue its appeal of the Department's determination that Simpson is a financial business.

¹Simpson also paid the B&O tax as assessed in the audit because RCW 82.32.180 requires a taxpayer to pay before filing a petition for refund in the Superior Court.

B. Simpson Is a Parent Holding Company Engaged (Along With Its Subsidiaries) in the Forest Products Business; the Department's Contrary Claim Would Effectively Deny the Benefits of the Section 4281 Deduction to Any Business Conducted Through a Parent-Subsidiary Corporate Structure.

The Department, citing RCW 82.04.290, states that since the Legislature has imposed a B&O tax on "every person engaging in business within this state," Simpson should be required to pay B&O tax on its investment income. Brief of Respondent at 9. Yet the Legislature has passed more than 60 deduction and exemption sections, including the Section 4281 deduction, and numerous other sections allowing credits from the tax. RCW 82.04.290; see also RCW 82.04.310 through 4332. While deductions are to be narrowly construed, if Simpson meets the Section 4281 deduction's criteria, then it is entitled to the deduction for its investment income. E.g., Sacred Heart Medical Center v. Department of Revenue, 88 Wn. App. 632, 636-37, 946 P.2d 409 (Div. II 1997) (reversing denial of sales tax exemption).

Here, the Legislature, by enacting the Section 4281 deduction, has determined that B&O tax should not be imposed on a person's investment income or "use of money as such" unless the person is "engaged in banking, loan security, or other financial businesses." RCW 82.04.4281. Moreover, the Legislature amended the Section 4281 deduction in 1970 to further provide that amounts derived as dividends by a parent from its subsidiaries are exempt from B&O tax. It is obvious that the Legislature recognized that a subsidiary of a parent corporation already pays B&O taxes on the subsidiary's business activities, and that these activities

should not be taxed a second time by taxing the dividends produced by these activities and paid to the parent corporation.

Simpson qualifies for the full benefit of the Section 4281 deduction, as amended in 1970. Simpson is engaged in the forest products business, through its subsidiaries.² And, Simpson also receives dividends from those subsidiaries, which the Department concedes are not subject to B&O tax. Brief of Respondent at 27, n.8. Nevertheless, the Department argues that, because Simpson makes investments and receives income from those investments, it must be a financial business.

This conclusion is based on the following construct. First, the Department declares that, since Simpson derives nearly all of its income from investment sources, it is a financial business. See Brief of Respondent at 8, 13 & 18. Second, the Department concedes that Simpson earns the overwhelming majority of its revenues from dividends received from its subsidiaries, and that this dividend income is exempt under the Section 4281 deduction. Id. at 27, n.8. Third, the Department contends that these dividends should nonetheless be included when computing the percentage of Simpson's investment income, under the Department's latest "bright line" test for determining whether a business

²During a portion of the period in question, Simpson also owned 100 percent of the stock of Pacific Western Extruded Plastics Company ("PWPipe"). Although PWPipe was not engaged in a forest products business, it was just as clearly not engaged in a financial business.

is a "financial business" under Section 4281. Id.³ Fourth, after the Department factors in the dividends Simpson receives from its subsidiaries, the Department declares that Simpson derives over 99 percent of its revenues from investment sources, and concludes that Simpson therefore is a financial business. Id. at 27.

Under this approach, it is difficult to imagine how any holding company would be entitled to the Section 4281 deduction. A holding company, by definition, owns the controlling stock in its subsidiaries and generally receives substantially all of its income in the form of dividends from subsidiaries.⁴ Such dividend income was specifically exempted from B&O tax by the Legislature's 1970 amendment to Section 4281, yet the Department includes these exempt dividend amounts in its investment income percentage calculation. This approach effectively nullifies the

³The Department's defense of the validity of this "bright line" test, set forth in ETB 571.04:146/109, is addressed, § II.H, infra, at 20-25.

⁴A holding company is generally defined as a corporation organized to hold the shares of other subsidiary corporations and, because of this ownership of shares, it controls and substantially influences the policies and management of its subsidiaries in a particular field of expertise. See, e.g., Fletcher Cyclopedia of Corporations, § 2821 at 333 (perm. ed. 1997); North American Co. v. Securities & Exchange Comm'n, 327 U.S. 686, 701, 90 L. Ed. 945, 66 S. Ct. 785 (1946). Simpson falls squarely within this definition -- it owns 100 percent of the shares of its subsidiaries; it provides supervisory management and administrative services to these companies; and all of the subsidiaries conduct business in the particular field of expertise (forest products and plastic pipe). (CP 85-87.)

availability of the Section 4281 deduction for all holding companies.⁵ Such a result conflicts with the established case law principles identified in Simpson's Opening Brief,⁶ and frustrates the Legislature's obvious purpose to avoid double B&O taxation with its potentially deleterious consequences for our state's economy.⁷

In fact, Simpson receives only minor amounts from its nondividend investment income. The Department assessed the disputed B&O tax and interest on the "investment income" Simpson received from the following three revenue sources: (1) interest on savings and bank deposits made under its cash management system; (2) dividends from stock in competitor companies; and (3) income from market hedging and futures trading. Although the Department repeatedly states that nearly all of Simpson's

⁵Thus, under the Department's approach, a parent holding company whose subsidiaries manufacture commercial airplanes would be deemed a financial business. Likewise, a parent holding company that has subsidiaries developing and manufacturing computer software would also be deemed a financial business.

⁶The Department urges this Court to disregard case law from other jurisdictions on this issue, claiming those cases turn on the wording of statutes different from Section 4281. Brief of Respondent at 20-21. But the Department ignores the consistent approach of the cases: A holding company is not to be treated as a financial business, unless the legislative branch has chosen expressly to authorize such treatment. Our Legislature has not made that choice -- to the contrary, the Legislature's express exclusion of dividends shows it has consciously made the opposite choice.

⁷The Department also argues that, because Simpson produces no products and receives nearly all its income from dividends and minor amounts of investment income, it is a financial business for purposes of the Section 4281 deduction. Brief of Respondent at 13 & 19. But, a holding company generally does not produce products; its subsidiaries do. Additionally, as the holding company for a group of forest product subsidiaries, Simpson must specialize in forest products to effectively manage and provide administrative services to its subsidiaries.

income is from investments, the Department is obviously well aware that only a small fraction of revenues were actually generated from these three revenue sources.

In response to a Request For Production from the Department, Simpson submitted a summary of its revenues for the years 1988 to 1995, depicted as percentage of total income, based on its Federal 1120 tax return. (CP 166.) Over the eight years charted, the average revenue generated from dividends Simpson received from its subsidiaries averaged 94.6 percent, while the revenue generated from interest on notes and contracts (1.2%), market hedging and futures trading (.4%), and the sale of stock in competitor companies (securities) (1%), cumulatively represented an average 2.6 percent of Simpson's total income. (CP 166.) Thus, if the dividends Simpson received from its subsidiaries are properly omitted from the equation, it emerges that Simpson received only 2.6 percent of its income from these three investment activities. See (CP 166).⁸

⁸The Department continues to rely heavily on the so-called "safe harbor" or "new bright line" test it presumed to adopt in June, 1995 through the issuance of Determination No. 93-269ER, 14 WTD 269, and the accompanying ETB 571.04.146/109 (collectively "ETB 571"). ETB 571 sets forth a two-part inquiry, including a percentage test under which the Department conclusively presumes that income is not from engaging in a financial business but is only incidental to nonfinancial business activities -- if the financial income is five percent or less of annual gross receipts. That percentage is to be computed by including all calendar or fiscal year financial income from loans and investments or the use of the money as such in the numerator, whether such income is "taxable, exempt, or deductible, and including all calendar or fiscal year revenues as normally measured by the B&O tax, including all revenues otherwise

(continued...)

C. This Court, in JOHN H. SELLEN CONSTRUCTION COMPANY v. DEPARTMENT OF REVENUE, Defined a "Financial Business" as One Whose Primary Purpose and Objective Is to Earn Income Through the Utilization of Significant Cash Outlays; Simpson Plainly Is NOT a Financial Business Under This Approach.

In John H. Sellen Construction Company v. Department of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976), this Court determined the applicability of the Section 4281 deduction⁹ to amounts a company derived from investments, by construing the term "financial business." Noting that the term was not defined in the statute, this Court looked to the term's ordinary meaning; based on that meaning, this Court held that a financial business is "a business whose primary purpose and objective is to earn income through the utilization of significant cash outlays." Sellen, 87 Wn.2d at 882. This Court rejected the Department's claim that a business becomes a financial business merely because it invests some

⁸(...continued)
exempt or deductible, in the denominator." ETB 571. For the reasons set forth in Section II.H, infra, this Court should invalidate the Department's latest "bright line" test. At a minimum, this Court should invalidate the use of the already tax exempt income (dividends from subsidiaries) from the formula, so that holding companies like Simpson can be accurately assessed on the amounts actually invested, rather than on the dividend income these companies receive because they own all or a controlling amount of their subsidiaries' stock. Even if this Court should adopt the second, narrower course, Simpson should prevail, as only 2.6 percent of its revenues qualify as generated by cash outlays from nonexempt sources.

⁹The Section 4281 deduction was, at the time of the Sellen decision, set forth in RCW 82.04.430 and contained the identical language now found in the Section 4281 deduction.

surplus funds in such things as time certificates, bank deposits, commercial paper, stocks and bonds, and real estate notes and mortgages:

Appellant [i.e., the Department of Revenue] equates investing any income with being a financial business and, in effect, this renders the statute a nullity. By interpretation, we should not nullify any portion of the statute.

Sellen at 883 (citations omitted).

Simpson's primary business purpose and objective is to oversee the operations of its subsidiary companies. During the audit period Simpson had 163 employees, only two of whom were employed in its cash management section, and its cash management section is only one of twelve sections in Simpson's organization. (CP 85, 91-93.) The Department can point to nothing in the record to dispute Simpson's mission, as reflected in its structure and staffing. Although the Department denies it, the Department is making essentially the same argument rejected by this Court in Sellen -- that because Simpson makes overnight incidental investments of surplus funds through a cash management system, Simpson is a financial business.

In fact, the only distinction proffered by the Department is its attempt to insert Simpson's already exempt dividend income into the equation, in order to "prove" that these cash management earnings are somehow typical of Simpson's investment income stream. See Brief of Respondent at 12, n.3 & 27, n.8. The Department's sole justification for its inclusion of dividends is that dividends constitute investment income. While sound economic arguments can presumably be made for classifying a parent's dividend payments from subsidiaries in such a fashion, the

Legislature has decided, for equally sound and countervailing economic considerations, to exclude dividends from subsidiaries for purposes of the Section 4281 deduction. In effect, in order to distinguish Sellen, the Department has invited this Court to disregard the Legislature's policy decision not to treat dividends from subsidiaries as investment income.

Moreover, this Court in Sellen also looked to the definition of "financial institution" to further classify and define a "financial business" as "an enterprise specializing in the handling and investment of funds (as a bank, trust company, insurance company, savings and loan association, or investment company)." Applying the rule of ejusdem generis, this Court concluded that "the generic term 'other financial businesses' must be read in conjunction with the terms 'banking, loan, and security.'" Sellen, at 883-84. Simpson falls squarely within this holding, as its primary purpose is to manage its subsidiaries' forest product businesses -- not to earn income through significant cash outlays. Simpson's operations are plainly not akin to those of a bank, trust company, insurance company, savings and loan association, or investment company, because Simpson does not specialize in the handling and investment of funds. See Sellen at 883-84. As the record conclusively establishes, Simpson is a nonmoneyed holding company involved in the forest products industry through its major subsidiaries, and is no more engaged in a "financial business" than were any of the taxpayers before this Court in Sellen.

D. This Court's Holding in RAINIER BANCORPORATION v. DEPARTMENT OF REVENUE Does Not Apply to Nonmoneyed Holding Companies Like Simpson.

The Department claims that Simpson is a financial business akin to the taxpayer at issue in Rainier Bancorporation v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982). See Brief of Respondent at 19-20. Yet Rainier Bancorporation was a bank holding company, whose wholly owned subsidiaries -- Rainier Bank, Rainier Mortgage Company, and Rainier Credit Company -- were also engaged in banking and related financial credit businesses. Unquestionably, these were moneyed companies whose primary purpose and objective was to earn income through the utilization of significant cash outlays. By contrast, Simpson is a nonmoneyed holding company engaged in the oversight of subsidiaries that are engaged in equally nonmoneyed business activities.

The Department nonetheless argues that Simpson is akin to Rainier Bancorporation because Simpson also "derives interest income from its investment of funds obtained from outside sources." Brief of Respondent at 19. While Simpson makes investments of surplus funds from its cash management system, they represent (as previously indicated) only some 2.6 percent of Simpson's gross revenues. See (CP 166). By contrast, Rainier Bancorporation engaged in business activities such as lending its subsidiaries approximately \$60 million during the relevant audit periods, less than half of which came from Rainier's surplus funds. Rainier at 673. To treat Simpson as the equivalent of Rainier Bancorporation would be to commit precisely the fundamental analytical error cautioned

against in Sellen: "If we adopt appellant's [i.e., the Department's] interpretation of RCW 82.04.430(1) [now Section 4281], then few taxpayers, if any, making incidental investments of surplus funds could receive the deduction." Sellen at 883.¹⁰

E. In 1993, the Legislature Defined "Financial Institution" Consistent With This Court's Decisions in SELLEN and RAINIER; the Department's Arguments About "Expanding" the Scope of the Exemption Are Wholly Irrelevant (or Not on Point).

In 1993, the Legislature amended RCW 82.04.290, the B&O tax rate section, to establish a lower tax rate "[u]pon every person engaging within this state in banking, loan, security, investment management, investment advisory, or other financial businesses. . . ." Laws of 1993, 1st Spec. Sess., ch. 25 § 203(2). In the same session, the Legislature also adopted RCW 82.04.055 (the section identifying "selected business services", a new B&O tax classification), to define the term "financial institution" as follows:

The term "financial institution" means a corporation, partnership, or other business organization chartered under Title 30 [banks and trust companies], 31 [miscellaneous loan agencies such as credit unions and industrial development corporations], 32 [mutual savings banks], or 33 [savings and loan associations] RCW, or under the National Bank Act, as amended, the Homeowners Loan Act, as amended, or the Federal Credit Union Act, as amended, or a holding company of any such business organization that is subject to the Bank Holding Company Act, as amended, or the Homeowners Loan Act, as amended, or a subsidiary or affiliate wholly owned or controlled by one more financial institutions, as well as a lender approved by the United States secretary of housing

¹⁰The Department also argues Simpson is like Rainier Bancorporation because it specializes in the handling and investment of funds by operating an elaborate cash management system. This patently false factual assertion is discussed in Section II.F, infra, at 15-18.

and urban development for participation in any mortgage insurance program under the National Housing Act, as amended.

Laws of 1993, Spec. Sess. ch. 25 §201(f) (emphasis supplied).

As noted above, this Court in Sellen relied on the term "financial institution" to determine the meaning of "financial business" as used in the Section 4281 deduction:

Courts also resort to dictionaries to ascertain the common meaning of statutory language. (citations omitted) Webster's Third New International Dictionary (1968) defines a "financial institution" as

an enterprise specializing in the handling and investment of funds (as a bank, trust company, insurance company, savings and loan association, or investment company).

Sellen at 883 (emphasis added). The Legislature's amendment thus has expressly conformed the statutory definition of financial institution to this Court's understanding of the term in Sellen.

The Department nonetheless claims that this Court's reference in Sellen to the dictionary definition of the term "financial institution" was only "for guidance," that the Court never intended to equate the term "financial business" with the term "financial institution," and that the Legislature's subsequent employment of the term is of no consequence. Respondent's Brief at 16-17. The Department's argument is contrary to established rules of statutory construction, which presume that "the legislature was acquainted with and had in mind, the judicial construction of former statutes on the subject, and that the statute was enacted in light of the judicial construction that the prior enactment had received, or in the light of such existing judicial decisions as have a direct bearing on it." Ashenbrenner v. Department of Labor and Industries, 62 Wn.2d 22, 26,

380 P.2d 730 (1963) (citation omitted). The Legislature's addition of "investment management" and "investment advisor" to the list of "financial businesses" under RCW 82.04.290, as well as the new definition for the related term "financial institution," are consistent with the scope of this Court's construction and interpretation of "financial business" in Sellen and Rainier -- and inconsistent with the Department's claim that Simpson should be treated as a "financial business."¹¹

F. Simpson's Use of a Cash Management System Does Not Make It a Financial Business; the Department's Contrary Claim Is Based on a Mischaracterization of the Actual and Undisputed Facts Found in the Record in This Case.

The Department attempts to bolster its argument that Simpson is a financial business by repeatedly stating that Simpson has a cash management system which is "peculiar," "elaborate" and "atypical of the structure and system used by most major corporations in this state and elsewhere." See Respondent's Brief at 2, 19, 20 & 21. These allegations are plainly contrary to the facts established by the record of this case.

The Department made these same allegations in its Memorandum in Opposition to Motion for Summary Judgment (CP 145), without any

¹¹Perhaps recognizing the weakness of its principal contention, the Department also argues that the Section 4281 deduction "stands alone," and that "the terms 'financial institution' and 'financial services' only pertain to activities associated with banks or savings and loan associations." Respondent's Brief at 15. The Department cites no rule of statutory construction or other authority to support these assertions. In fact, these assertions conflict with the established rule of statutory construction calling for in pare materia construction and interpretation of common terms that are part of a comprehensive statutory scheme. See, e.g., University of Washington v. Jacobs, 68 Wn. App. 44, 49, 842 P.2d 971 (1992), rev. denied, 121 Wn.2d 1018, 854 P.2d 41 (1993) (citations omitted) ("statutes relating to the same subject must be read together").

citation to authority for the statements. In reply, Simpson specifically refuted these allegations by submitting the Declarations of Michael M. Gibson and Susan V. Duff, with two letters attached from Aina K. Harkey, Vice President, Mellon Bank, stating that Simpson's cash management system is neither "peculiar," "elaborate" nor "atypical." (CP 197-98.)

In Mr. Gibson's declaration, he stated:

6. Likewise, a group of related corporations will generally have a cash management system in place, similar to Simpson's cash management system, for purposes of managing the cash receipts and disbursements of all the commonly-owned group of corporations. In fact, many major corporate groups of which I am familiar have such a cash or money management system in place.

7. The typical cash management system includes income and disbursement accounts for each of the operating companies and a concentration account that funds and/or provides funds to all of the other accounts. The concentration account will also receive any excess funds from the subsidiary accounts, usually on a daily basis, for overnight investment. The concentration account is generally owned by the parent corporation. I would characterize this system as good financial management of the business enterprise.

8. In summary, the organizational structure and cash management system utilized by Simpson Investment Company is very typical of the structure and systems utilized by a group of corporations the size of the Simpson family of corporations. In my dealings and representation of clients, I am aware of many other major corporate organizations in the State of Washington, and elsewhere, that utilize similar organizational structures and cash management systems in their business operations. Like Simpson Investment Company and its subsidiaries, those companies are engaged in various manufacturing-related industries and non-financial businesses which are not, in any sense of the term, deemed to be financial businesses.

(CP 214-15.)

In Ms. Harkey's letter dated March 13, 1997, she stated:

Most large corporations in the US have developed systems through which they can concentrate funds into either a single location (bank) or a single account (bank) It is crucial for the company to have a good balance reporting program in order to know when there are excess funds and when they will be concentrated for effective use.

Within my territory in the Pacific Northwest . . . the majority of our customers utilize this concentration of funds method. . . . In conjunction with the concentration of funds, these companies utilize a centralized disbursement account (or multiple accounts) through which flow all payments. As is the case at Simpson, the paper disbursements are "controlled," clearing through a bank who is capable of providing a total clearing amount for that day early enough in the morning, and match the totals against the available funds concentrated. This allows the company to either initiate a borrowing or invest any excess funds into debt paydown or a short term money market fund.

Within the State of Washington, Mellon provides similar cash management services for insurance companies (2), manufacturing companies (2), and we [re]call . . . any number of retailers and service companies doing the same with other banks.

(CP 223-24.)

The Department did not dispute these facts with any declarations, documents, or other kind of evidence. Yet the Department, without so much as a passing acknowledgment of the actual facts set forth in the record, tells this Court -- as the Department claimed before the Superior Court -- that Simpson has created and operates a peculiar, elaborate, atypical cash management system, and therefore is akin to a financial business. In reality, and as the record reflects, Simpson's cash management system is a standard product it purchased from commercial banks. Mellon Bank, for example, ". . . sells and provides cash management products and services (electronic or paper-based or ones which utilize software programs developed and marketed by the bank), all

which have one thing in common: they must all be associated with a demand deposit account maintained at the bank." (CP 220.) Simpson does not sell or provide these services, nor does it have the capability to do so. Id. In short, if Simpson's cash management system makes it a financial business, then the same must be said of virtually any corporate enterprise in this state.

G. Simpson, as a Parent Holding Company, Provides Common Administrative Services at No Cost to Its Subsidiaries; the Department's Contrary Claim Is Unsupported by the Record and Constitutes a Wholly Improper Attempt to Repudiate on Appeal What the Department Conceded During the Audit Process.

The Department also states as a fact that ". . . Simpson indirectly receives payment for services it provides its subsidiaries through the overnight interest it receives from its investment of its subsidiaries excess funds pursuant to an elaborate cash management system," Brief of Respondent at 5, citing CP 85. There is no more support for this statement in the record than there is for the Department's characterization of Simpson's cash management system. To the contrary, the only relevant evidence in the record, the Declaration of Joseph R. Breed, Vice President, General Counsel and Secretary of Simpson, establishes that Simpson performs shared services for its subsidiaries; does not make intercompany charges for its personnel services; and is "run as a cost center with its major source of revenue being B&O tax exempt dividends from its subsidiaries." (CP 85.)

Nowhere in Mr. Breed's declaration is there any indication that Simpson is indirectly receiving payment for its management and

administrative services through the overnight interest Simpson received from the investment of surplus funds. In fact, Simpson's operating costs are paid from revenues generated primarily from dividends received by Simpson from its subsidiaries (on average 95 percent). (CP 85, 166.) The investment income received from the overnight deposits of surplus funds is returned daily to the concentration account for use by its subsidiaries. (CP 95.) Thus, the Department's argument that these funds should be imputed as payment for Simpson's administrative costs has no basis in the record.

In fact, the amount of revenue Simpson receives from dividends compared to interest or investment income was provided to the Department, recognized by the Department, and not disputed by the Department. See (CP 166, 280). The Department made this same "indirect payment for services" argument in its Memorandum In Opposition To Plaintiff's Motion For Summary Judgment, but cited no authority, nor offered anything in the record to support the allegation; the Superior Court did not adopt the Department's reasoning, or even address the issue in its decision. See (CP 291-92). Yet the Department again makes this allegation, even though counsel for the Department should be fully aware that nothing in the record supports the allegation, and that the Department's audit and schedules adjusting the audit specifically make written determinations expressly to the contrary.¹²

¹²To fully apprise this Court of the relevant facts, and given the decision by the Department's counsel to revive the "indirect payment"
(continued...)

To summarize: (1) in its audit, the Department acknowledged that Simpson does not charge for its management and administrative services; (2) during the audit process, the Department conceded the "cost for services" argument with regard to the imposition of B&O tax on dividends; and (3) these services are on average nearly 95 percent paid through the receipt of dividends. The Department's present claim thus appears to be nothing less than an attempt to prejudice the Court, by reviving a theory expressly abandoned at the audit stage. That theory is also unsupported by the record and should be summarily rejected.

H. The Department's Own Determinations Do Not Support Its Present Claim That Simpson Is a Financial Business, and Its Recent Attempt to Evade Those Determinations by Promulgating a New "Bright Line" Rule (ETB 571) Is an Evasion of This Court's Controlling Decisions and a Violation of the Administrative Procedures Act.

The Department's own determinations recognize the common use of cash management systems in today's business world. For example, in Final Determination No. 86-309A, 4 WTD 341 (1987) ("4 WTD 341"),¹³ the Department acknowledged, as Simpson argues here, that cash management systems are common business tools:

¹²(...continued)
claim, Simpson now attaches as Appendix A to this reply brief the correspondence and audit schedule adjustments sent by the Department to Simpson in which the Department deletes Schedule II (the service B&O tax on Simpson's dividend income), and confirms Schedule III of the audit narrative (the basis for the Department's determination that Simpson is a financial business). Simpson moves, under RAP 9.11, that this material be added to the record on review.

¹³Final Determination No. 86-309A, 4 WTD 341 (1987), is a published decision of the Department, and therefore deemed precedential. RCW 82.32.410.

The more recent technological advances within the financial and banking industries have made possible the instantaneous electronic movement of funds between related accounts which enables the sophisticated and highly efficient methods of managing business capital to achieve the most beneficial availability and use of such funds. Thus, by various methods of assuring these efficiencies, many vertically integrated business organizations have developed internal control networks for daily money movement between their respective subsidiary and affiliate entities. Such centralized money management techniques generally involve the daily funding of operating subsidiaries by the parent or managing entity and the end of day sweeping of all subsidiary accounts down to a zero or minimum targeted balance. Banks and other financial institutions have developed and marketed such programs which they will manage for a fee.

(CP 242.)

In fact, the Department determined in 4 WTD 341 that a cash management system did not result in taxable income to the taxpayer, for two distinct and independent reasons. (CP 245.) First, money management systems do not result in any actual payments or receipts to the taxpayer because these activities merely result in the movement of already taxed money "from one pocket to another." Id.; see also (CP 214). The Department reasoned that the money management system employed by the subject taxpayer in 4 WTD 341 was simply "the use of money as such" under the Section 4281 deduction, and did not constitute the making of investments in any traditional sense. Id. Second, the Department held that "business entities do not assume the characteristics or functions of 'financial businesses' comparable to banks, loan companies, or investment companies, merely by virtue of performing internal fiscal functions." Id.

Contrary to the Department's claim in this case, Simpson's cash management system, like all cash management systems, is akin to a sophisticated checking account.¹⁴ The fact that the interest was, for bookkeeping purposes, attributed to Simpson as the funds manager, is no different than the loan interest booked to the taxpayer parent-company in 4 WTD 341. Moreover, following the issuance of 4 WTD 341, the Department established in a later determination (6 WTD 89) a "bright line test" for determining whether a parent company's money management system constituted the "use of money as such," and thus not entitled to the Section 4281 deduction. This departmental decision was addressed in Simpson's opening brief (at pp. 46-47), and the Department does not dispute that Simpson's cash management system qualified for the deduction under this test.

The Department, however, presumed to jettison the 4 WTD 341 "bright line" test with the adoption of a "safe harbor" or "new" bright line

¹⁴To better understand the workings of a cash management system, it may be helpful to compare this system to a typical family checking account. Simpson would be analogous to a parent who had the responsibility for managing the family household checking account and also had access to other accounts maintained by children. The parent would simply review each child's checking account daily and from the parent's "concentration account" would sweep out any excess funds or add funds if a particular child's checking account was running "in the red," i.e., a deficit balance. The funds in the household concentration account would be receiving interest through overnight deposits and that interest would be turned back into the household concentration account. In this manner the parent would be able to make sure each child, while away at college for example, would have sufficient money in the child's checking account to meet daily cash needs, but yet if the child had too much money in his or her account, would ensure it was not frivolously used by sweeping the excess into the household concentration account.

test in yet another published decision: Determination No. 93-269ER, 14 WTD 269 (1995), and the conforming issuance of Excise Tax Bulletin 571.04.146/109 (collectively "ETB 571"). In ETB 571, the Department claims the authority to impose a percentage test to determine whether a taxpayer is a "financial business" for purposes of the Section 4281 deduction.

ETB 571 conflicts with this Court's Sellen and Rainier decisions. The safe harbor test's percentage inquiry only measures the annual level of investment income generated by a business, ignoring the business's primary purpose and objective -- the test employed by this Court in Sellen and Rainier.¹⁵ The Department's establishment of the five percent safe harbor test also violates the rule-making provisions of the Administrative Procedure Act ("APA"), RCW Chapter 34.05. Even if the Department had the authority to adopt such a test, it must be adopted as an administrative rule with the attendant due process and notice requirements mandated by the APA, and the Department clearly did not conform to these requirements when it promulgated ETB 571.

Confronted with these facts, the Department falls back on the judicially adopted rule of law that when "interpreting a statute, great

¹⁵Thus, a business in the forest products industry (like Simpson), or any other nonmoneyed industry, could exceed the five percent test and be held to be a financial business one year and not a financial business the next year, merely because it did (or did not) exceed the five percent test. It is doubtful that either the Legislature or this Court envisioned such a variable application of the Section 4281 deduction. A taxpayer is either engaged in a financial business or it is not, based on the business's primary purpose and objective, something that is unlikely to change from year to year.

weight must be accorded to the contemporaneous construction placed upon it by officials charged with its enforcement, particularly where that construction has been accompanied by silent acquiescence of the legislative body over a long period of time." See Brief of Respondent at 29, citing Bennett v. Hardy, 113 Wn.2d 912, 928, 784 P.2d 1258 (1990). How can the Department seriously argue that the Legislature has "silently acquiesced" in this interpretation "over a long period of time," when ETB 571 is less than three years old? Moreover, ETB 571 does not represent a contemporaneous interpretation of the Section 4281 deduction, but a belated attempt by the Department to evade the strictures of Sellen and Rainier years after the issuance of those decisions by this Court.

The Department also claims that, because it is the agency "charged with interpreting Washington tax statutes . . . its interpretation of the Section 4281 deduction is entitled to great weight even if ETB 571 is not a properly adopted rule." Brief of Respondent at 29-30 (emphasis added). This statement is nothing short of astonishing. In other words, the Department is saying, "never mind the APA, defer to us because we're an agency." Simpson submits that this Court should not allow the Department to violate state law, on the mere premise that "great weight must be accorded" its administrative construction of the law. Even though the Department is the agency charged with interpreting the statute, it must follow the law in doing so. If this Court accepts the Department's claim of right to disregard the APA, every state agency could likewise exceed its authority, trammel upon individual rights, then hide behind the shield

of its administrative expertise. This Court should send a clear message to the Department, and any other agency that believes it has the authority to disregard the mandates of the Legislature, that such practices will not be condoned.

III.

CONCLUSION

Simpson is entitled to a deduction for its investment income under the Section 4281 deduction. This Court should reverse the judgment of the Superior Court, and mandate the entry of an order in favor of Simpson.

RESPECTFULLY SUBMITTED this 25th day of February, 1998.

LANE POWELL SPEARS LUBERSKY LLP

By Michael B. King
George C. Mastrodonato
WSBA No. 07483
Michael B. King
WSBA No. 14405
Kathleen D. Benedict
WSBA No. 07763
Attorneys for Appellant
Simpson Investment Company

CERTIFICATE OF SERVICE

I hereby certify that a copy of this document was served via U.S. MAIL AT LAST KNOWN ADDRESS

On: JOHN S. BARNES, ESQ.

Date: FEBRUARY 25, 1998

By: Robin P. Uley

APPENDIX

Appendix Exhibit A

Correspondence and Audit Schedule Adjustments



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

11707 21st Ave. S., Ste. B, P.O. Box 44010 • Tacoma, Washington 98444-4010 • (206) 536-6278

May 6, 1993

George C. Mastrodonato
c/o Lane, Powell, Spears & Lubersky
Evergreen Plaza Bldg
711 Capitol Way
Olympia, WA 98501-1231

RE: Telecon May 5, 1993 with Sue Duff, Sue Brabham and Mary Lachapelle

Dear George:

The following summarizes my understanding of our teleconference this morning.

Foreign Sales Corporation

Schedule II titled "Unreported Commissions & Profit Checks" will be deleted from the audit.

Schedule III titled "Reimbursements from Affiliates to SFSC" will remain and, I am assuming, will be appealed. Again, it is our contention that the amounts listed on this schedule are not valid reimbursements within the context of WAC 458-20-111, but recovery of costs of doing business.

Simpson Investment Company

Schedule II titled "Service B&O Tax Due on Dividend Income" will be deleted.

Schedule III titled "Tax Due on Unreported Revenue & Cost Recoveries" will have the following line items deleted per Mark Gray memo dated 12/11/92 sent by Sue Duff:

Cost Transfers	Acct#939 22 838 000	.....	\$1,197,122
Cost Transfers	" " 939 22 839 100	.....	518,001
Cost Transfers	" " 939 24 839 000	.....	1,238,432
Int Cost Trsf	" " 939 25 839 941	.....	120,554
Cost Trans/Intra	" " 939 22 839 000	.....	21,214

The following accounts will not be deleted because they appear to be the recovery of costs from the Foreign Sales Corporation. (Please refer to WAC 458-20-111):

Credit Costs	Acct#820 700 056	.....	\$ 5,352
Credit Risk	" " 942 01 962 013	.....	206,430

The last issue is whether or not Simpson Investment Company is a financial business. Please refer to the audit narrative under Schedule III for our reasoning and references regarding this subject.

Simpson Tacoma Kraft Company (STKCo)

The following will be reversed from Schedule III titled "Deductions from Manufacturing Disallowed":

Commissions-Paper Export	.....	\$ 3,887,757
Commissions-Pulp Export	.....	3,426,802
Planas/McRostic Payment	.....	(316,001)

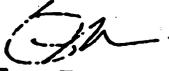
EXHIBIT A



George C. Mastrodonato
May 6, 1993
Page Two

Please contact me if there is any item I missed or if there are additional topics you would like to discuss. I will effect the post audit adjustments as soon as possible and send them to the appropriate people for review.

Sincerely,



Guy E. Marsh
Field Auditor
(206) 536-6246

cc: Sue Brabham, STKCo
Sue Duff, Excise Tax Supervisor
Jim Munro, Supervising Field Auditor
Don Rankin, Regional Audit Manager

GM:cay



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

11707 21st Ave. S., Ste. B, P.O. Box 44010 • Tacoma, Washington 98444-4010 • (206) 536-6278

May 6, 1993

Susan V. Duff, Excise Tax Supervisor
Simpson Investment Company
1201 Third Avenue, Suite 4900
Seattle, Washington 98101-3009

RE: Post Audit Adjustments for --
Simpson Investment Co. 600 614 906
Simpson Foreign Sales Corp. 601 188 993

Dear Ms. Duff:

Enclosed are schedules adjusting subject audits. These schedules should hold all agreed upon deletions and reversals from our meeting of December 14, 1992 and our teleconference May 5, 1993.

Two of the accounts referred to in Mark Grays memo of December 11, 1992 have not been deleted as requested because they are associated with another corporation, i.e., Simpson Foreign Sales Corp. I will need additional documentation to demonstrate how these cost recoveries are "intra" rather than "inter" corporate in nature.

Please contact me by May 14th if there are changes you feel should be made to subject schedules.

Sincerely,

Guy E. Marsh
Field Auditor
(206) 536-6246

GEM:mgb

cc: James J. Munro, Sr., Supervising Revenue Auditor
Don Rankin, Regional Audit Manager



SCHEDULE I
 V 2.01. 05-91
 PAGE 1 OF 1
 SIMPSON INVESTMENT COMPANY 500 516 004
 PAA #1 - SUMMARY OF TAX ADJUSTMENTS BY CLASSIFICATION
 SOURCE: SUPPLEMENTAL SCHEDULES II THROUGH III

SCHEDULE
 REFERENCE

	1988	1989	1990	1991	TOTALS
SERVICE AND OTHER ACTIVITIES - 004					
PAA #1 - REVERSE TAX ASSERTED ON ORIGINAL SCHEDULE II TITLED "SERVICE & O TAX DUE ON DIVIDEND INCOME (CHARGES FOR SERVICES)"	(952,177)	(725,598)	(1,595,545)	(762,819)	(4,036,129)
PAA #1 - TO REVERSE CERTAIN ITEMS TAXED ON ORIGINAL AUDIT SCHEDULE III TITLED "TAX DUE ON UNREPORTED REVENUE AND COST RECOVERIES"	(11,439)	(13,748)	(21,093)	0	(46,280)
TOTALS	(963,616)	(739,336)	(1,616,638)	(762,819)	(4,082,409)

SCHEDULE II

SCHEDULE III

SCHEDULE :

SON INVESTMENT COMPANY 600 614 906

PAGE 1 OF 1

REVERSE TAX ASSERTED ON ORIGINAL SCHEDULE IS TITLED "SERVICE B & C TAX DUE ON DIVIDEND INCOME (CHARGES FOR SERVICES)"

ACCOUNT #	DESCRIPTION	1988	1989	1990	1991	TOTALS
810401099	DIVIDEND INC-STCO				(45,200,000)	(45,200,000)
810408199	DIVIDEND INC-SFSC				(5,534,590)	(5,534,590)
971 99 853 000	DIVIDEND INCOME	(117,074)	(121,067)	(125,453)		(363,594)
971 99 853 001	DIVIDEND INCOME-STCO	(5,978,000)	(14,411,000)	(49,336,000)		(69,727,000)
971 99 853 013	DIVIDEND INCOME-SFCO	(17,363,390)	(17,394,468)	(11,460,197)		(46,218,055)
971 99 853 015	DIVIDEND INCOME-PWP	(4,083,000)	(351,000)	(4,196,000)		(8,630,000)
971 99 853 031	DIVIDEND INCOME-SPCO	(35,937,000)	(16,095,000)	(41,250,000)		(93,282,000)
Total Amounts Subject to Credit		(63,478,464)	(48,372,535)	(106,369,650)	(50,854,590)	(269,075,239)

Service And Other Activities B&O
Tax Rates:
8.015 (1/87)

Total Credit Differences To Schedule :

(952,177)	(725,588)	(1,595,545)	(762,819)	(4,036,129)
(952,177)	(725,588)	(1,595,545)	(762,819)	(4,036,129)

NOTE: Differences Due To Rounding May Be Present In This Schedule

SCHEDULE III
 SIMPSON INVESTMENT COMPANY 600 614 906
 SEATTLE LOCATION
 PAGE 1 OF 1 PAA #1 - TO REVERSE CERTAIN ITEMS TAXED ON ORIGINAL AUDIT SCHEDULE III TITLED "TAX DUE ON UNREPORTED REVENUE AND COST RECOVERIES"
 REFERENCE: GENERAL LEDGER

ACCOUNT #	DESCRIPTION	1988	1989	1990	1991	TOTALS
939 22 838 000	COST TRANSFERS TO BAL SHF ACCT V/P DIST	(260,384)	(187,865)	(738,873)		(1,187,122)
939 22 939 100	COST TRANSFERS-INT (MINCE)	(122,434)	(233,252)	(162,315)		(518,001)
939 24 839 000	COST TRANS-INTRACORP P&L ACCT	(358,226)	(495,417)	(384,789)		(1,238,432)
939 25 839 941	INT COST TRANS-STCO INFO CTR CSTS	(333)		(120,221)		(120,554)
939 22 839 000	COST TRANS-INTRACORP P&L ACCT	(21,214)				(21,214)
Total Amounts Subject to Credit		(762,591)	(916,534)	(1,406,198)	0	(3,085,323)

Service And Other Activities B&O
 Tax Rates:
 @.015 (1/87)

(11,439)	(13,748)	(21,093)	0	(46,280)
(11,439)	(13,748)	(21,093)	0	(46,280)

NOTE: Differences Due To Rounding May Be Present In This Schedule

SCHEDULE I
fsaa_1

SIMPSON FOREIGN SALES CORPORATION 601 188 993
SEATTLE LOCATION

PAGE 1 OF 1

PA# #1 - TO REVERSE TAX ASSERTED ON ORIGINAL AUDIT SCHEDULE II TITLED "UNREPORTED COMMISSIONS & PROFIT CHECKS"
REFERENCE: 1985, 89 YTD GENERAL LEDGER, 1990 JOURNAL VOUCHERS, 1991 CHECKS WRITTEN FROM AFFILIATES-FSC BUY/SELL AGREEMENT

	1988	1989	1990	1991	TOTALS
TOTAL AMOUNTS REVERSED SUBJECT TO CREDIT	(19,692,203)	(27,953,317)	(17,252,720)	(9,571,807)	(74,470,047)
Service And Other Activities B&O	(295,383)	(419,300)	(258,791)	(143,577)	(1,117,051)
Tax Rates:	(295,383)	(419,300)	(258,791)	(143,577)	(1,117,051)
e.015 (1/87)					

Total Credit Differences To Schedule I

NOTE: Differences Due To Rounding May Be Present In This Schedule

LANE
POWELL
SPEARS
LUBERSKY

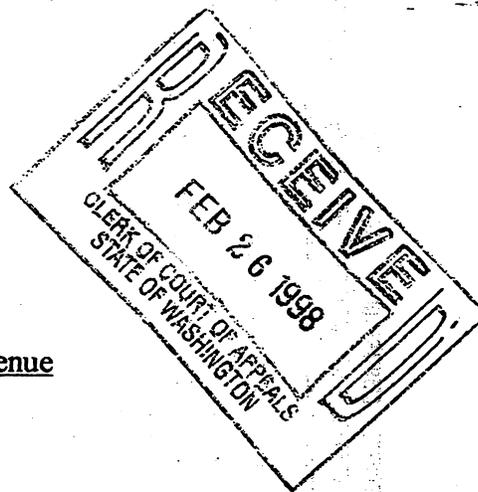
LLP

February 25, 1998

Michael B. King
(206) 223-7000

VIA OVERNIGHT DELIVERY

Clerk of Court
Court of Appeals Division II
945 S Market ST
MSS-TB06
Tacoma, WA 98402-3694



Law Offices

A Limited
Liability
Partnership
Including
Professional
Corporations

1420 Fifth Ave.
Suite 4100
Seattle, WA
98101-2338

(206) 223-7000

Facsimile:
(206) 223-7107

Re: Simpson Investment Co. v. Department of Revenue
Court of Appeals No. 22907-2-II
Former Supreme Court No. 65394-1

Dear Clerk:

Enclosed for filing is Appellant Simpson Investment Co.'s Reply Brief.

When the Supreme Court transferred the case to this Court for disposition, Appellant was working towards completion of its reply brief (with the Supreme Court title page and format). It is our understanding that we could proceed to completing the brief in that form, and we have done so. The corresponding Court of Appeals, Division II case number is: 22907-2-II.

If you have any questions, please call.

Respectfully,

LANE POWELL SPEARS LUBERSKY LLP

Michael B. King
Michael B. King

MBK:hmn

Enclosure

cc: John S. Barnes, Esq. (Counsel for Respondent)
George C. Mastrodonato, Esq.
Kathleen Benedict, Esq.

Anchorage, AK
Fairbanks, AK
Los Angeles, CA
Mount Vernon, WA
Olympia, WA
Portland, OR
San Francisco, CA
Seattle, WA
London, England

CERTIFICATE OF SERVICE

I hereby certify that a copy of
this document was served via
U.S. MAIL AT LAST KNOWN ADDRESS

On: JOHN S. BARNES, ESQ.

Date: FEBRUARY 25, 1998

By: Robin P. Kelly

APPENDIX D

FILED
MAR 2 1999

CLERK OF SUPREME COURT
STATE OF WASHINGTON
ML

No. 67630-5

SUPREME COURT
OF THE STATE OF WASHINGTON

SIMPSON INVESTMENT COMPANY,

Respondent

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Petitioner

ON PETITION FOR REVIEW FROM
COURT OF APPEALS, DIVISION II

ANSWER TO PETITION FOR REVIEW

BY C. J. HERNITT

99 MAR 24 AM 10:29

RECEIVED
SUPREME COURT
STATE OF WASHINGTON

George C. Mastrodonato
WSBA No. 07483
Michael B. King
WSBA No. 14405
Kathleen D. Benedict
WSBA No. 07763
LANE POWELL SPEARS LUBERSKY LLP
Attorneys for Respondent
Simpson Investment Company

Lane Powell Spears Lubersky LLP
2120 Caton Way S.W., Suite B
Olympia, Washington 98502
Telephone: (360) 754-6001
Facsimile: (360) 754-1605

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES	ii
A. Summary of Grounds for Denying Review	1
B. Issue Actually Presented by the Petition	2
C. Statement of the Case	3
D. Why Review Should Be Refused	8
1. The Court of Appeals Correctly Applied the Law Governing RCW 82.04.4281, Without Creating Any Conflict With Decisions of This Court	8
2. The Department Ignores the Purpose and Function of Holding Companies	11
3. Simpson's Business Is the Same as Its Subsidiaries	13
4. The Department Seeks Review on Grounds Different From the Positions That the Department Took Before the Court of Appeals	14
E. Conclusion	19

TABLE OF AUTHORITIES

Page

CASES

<u>American Sign & Indicator Co. v. State</u> , 93 Wn.2d 427, 610 P.2d 353 (1980)	14
<u>John H. Sellen Constr. Co. v. Department of Revenue</u> , 87 Wn.2d 878, 558 P.2d 1342 (1976)	1, 2, 8, 9, 11, 13, 17, 18, 19, 20
<u>Nordstrom Credit, Inc. v. Department of Revenue</u> , 120 Wn.2d 935, 845 P.2d 1331 (1993)	13
<u>North American Co. v. Securities & Exchange Commission</u> , 327 U.S. 686, 90 L. Ed. 945, 66 S. Ct. 785 (1946)	12
<u>Rainier Bancorp. v. Department of Revenue</u> , 96 Wn.2d 669, 638 P.2d 575 (1982)	1, 2, 8, 9, 13, 14, 17, 18, 19, 20
<u>Rena-Ware Distribs., Inc. v. State</u> , 77 Wn.2d 514, 463 P.2d 622 (1970)	14
<u>Simpson Investment Company v. Department of Revenue</u> , 92 Wn. App. 905, 965 P.2d 654 (1998)	1, 3, 4, 5, 9, 11, 14, 18
<u>Washington Sav-Mor Oil Co. v. State Tax Comm'n</u> , 58 Wn.2d 518, 364 P.2d 440 (1961)	14

STATUTES AND COURT RULES

RCW 82.04.4281 2, 3, 8, 9,
13, 14, 15, 16,
17, 19, 20

RAP 13.4(b) (1) 1

RAP 13.4(b) (4) 1, 17

MISCELLANEOUS

2 A. Dewing, The Financial Policy of
Corporations (4th ed. 1941) 12

R. Spector, Family Trees: Simpson's
Centennial Story (1990) 12, 13

Sweep Accounts Simplify Finances,
The Olympian, Feb. 2, 1999 5

Turning a Titan, Puget Sound
Business Journal (June 26-
July 2, 1998) 19

Excise Tax Bulletin 571.04.146/
109 (ETB 571) 15, 16, 17, 19

Excise Tax Advisory No. 2001 17

Final Determination No. 86-309A, 4
WTD 341 (1987) 18

A. Summary of Grounds for Denying Petition.

This Court should deny the Department of Revenue's Petition for Review because the Court of Appeals' Decision¹ does not warrant review under either RAP 13.4(b) (1) or (4).

First, the Decision is in accord with this Court's decisions in John H. Sellen Constr. Co. v. Department of Revenue, 87 Wn.2d 878, 558 P.2d 1342 (1976) ("Sellen"), and Rainier Bancorp. v. Department of Revenue, 96 Wn.2d 669, 638 P.2d 575 (1982) ("Rainier"). Second, the Petition does not present an issue of substantial public interest requiring a ruling by this Court, as the Court of Appeals correctly applied the legal principles previously established by Sellen and Rainier.

What the Department actually seeks is for this Court to overturn existing law and create an exception to well established legal principles governing the construction and interpretation of the business and occupation ("B&O") tax deduction

¹The reported citation is Simpson Investment Company v. Department of Revenue, 92 Wn. App. 905, 965 P.2d 654 (1998). The decision will be referred to either as "Decision" or "Simpson," and citations will be to the reported form.

statute, RCW 82.04.4281 (also referred to herein as "the Section 4281 Deduction"), at issue in this case. This Court should decline the invitation to create that exception, and deny review.

B. Issue Actually Presented by the Petition.

The Department claims that the Respondent Simpson Investment Company is a "financial business," based solely on the source of Simpson's revenues. In Sellen and Rainier, this Court held that a company's "primary purpose and objective" determines if it is a "financial" business. If a company's primary purpose and objective is not "to earn income through the utilization of significant cash outlays," the company is not a "financial business." See Sellen, 87 Wn.2d at 882; Rainier, 96 Wn.2d at 673. What the Department actually wants this Court to do is depart from its holdings in Sellen and Rainier, and adopt an interpretation of RCW 82.04.4281 which would effectively classify all holding companies doing business in this state as "financial businesses," thereby preventing any such company in this state from qualifying for the deduction -- no matter the business engaged in by the holding company or its subsidiaries. The real

issue therefore is whether this Court should grant review to consider effecting such a change in Washington law.

C. Statement of the Case.

The relevant facts are accurately and fully set forth in the Court of Appeals' decision terminating review, at pages 910 through 913 of the Decision. Simpson's Statement of the Case will supplement the Court of Appeals' statement of facts solely to correct misstatements of the Department regarding Simpson's source of income.

The Department states that "Simpson earns 100 percent of its income from investment sources." Petition at 3. In fact, Simpson's primary source of revenue is dividends from its subsidiaries,² which during the tax periods in question comprised more than 95 percent of Simpson's income. (CP 35, 166); see Simpson, 92 Wn. App. at 923, n.19. Simpson's income from investment sources comprised five percent or less of its total income during the periods in

²The B&O tax does not apply to dividends received by a parent company from its subsidiary corporations, under the second clause of RCW 82.04.4281.

question, Simpson, 92 Wn. App. at 923, n.19, and this limited investment income was derived from three primary sources:

- Interest Earned on Savings and Bank Deposits Through the Operation of a "Cash Management" System. (CP 94.) Cash management systems are programs developed by banks for their customers, and are designed to minimize outside borrowing by first utilizing all of the liquid resources of the group of related entities. (CP 242.) Simpson coordinated the "cash management" system which consisted of a concentration account maintained by Simpson and various accounts maintained by its subsidiaries. (CP 95.) Deposits and disbursements from accounts maintained by the subsidiary companies flowed through Simpson's concentration account. Id. The movement of cash between bank accounts determined the daily cash position for Simpson as well as for all of the Simpson entities. Id. This cash position also determined the daily consolidated

borrowing requirements or investment opportunities for the companies. Id.³

The daily transfers of cash between the parent and subsidiary accounts sometimes resulted in excess cash available for investment in the concentration account, and Simpson (as coordinator) invested these account funds in overnight, short term deposits in its name as funds manager. (CP 95-96.) The interest income earned on these short term investments was deposited into the Simpson concentration account and included in the beginning daily bank account balance the next business day. (CP 95-96.) While

³In sum, cash management is nothing more than a sophisticated checking account that earns interest on the liquid funds held on deposit each day. Id. As the Court of Appeals succinctly stated:

Simpson is not in competition with financial businesses [I]ts receipt of interest from overnight bank account deposit of surplus funds is an "incidental" activity that is not essentially in competition with financial businesses. Simpson is merely a bank customer, receiving, not performing, normal banking services.

Simpson, 92 Wn. App. at 922; see Sweep Accounts Simplify Finances, The Olympian, Feb. 2, 1999 (copy attached as Ex. A to the Appendix of this Answer).

these funds were available for use by all Simpson-related entities, there was no evidence of the creation of any creditor-debtor relationship between the entities, on either a demand or term payment basis.⁴

● Dividends From Stock Held in Other Companies. The second major source of Simpson's investment income was dividends from small amounts of common stock (typically 100 shares) in competitor forest products companies. (CP 98.) Simpson owned this stock in order to track the activities of its competitors and to obtain financial information which was available to shareholders of those companies. (CP 98.) This information was then used in an industry database Simpson maintained for tracking its performance against competitors and for setting financial rating objectives. Id. The portfolio of stock

⁴Contrary to the Department's assertion that Simpson "makes frequent . . . loans . . . to its subsidiaries" (Petition at 18), there is absolutely nothing in the record to support this statement -- nor does the Department cite to anything in the record which would support this assertion. There were no promissory notes given, no debts were created, and no liability was recorded on the books of Simpson's subsidiaries.

was acquired strictly with the objective of gaining nonconfidential financial and other public information about Simpson's competitor companies, and in no way was intended to compete with brokerage and security businesses or mutual funds.

Id.⁵

• Gains From Lumber and Plywood Commodity Price Hedging. Lumber and plywood commodity trading was first in operation at Simpson Timber Company and later Simpson Investment Company between 1977 and April 1990. (CP 110.) The purpose of the trading was to reduce the price volatility inherent in the sale of lumber and plywood commodity items and was accomplished by selling contracts for the future delivery of lumber on the Chicago Mercantile Exchange when those prices exceeded the Corporate Plan Forecast or were higher than regular customers were willing to pay at the time. (CP 111.) When the

⁵Sometimes Simpson ended up with more than 100 shares of stock in the competitor companies because the companies would have stock splits or stock dividends. (CP 98.) When the number of shares increased to a point where it was practical, Simpson would, from time to time, sell excess shares to bring the balances down to 100 shares. Id.

expiration date for the futures contract approached, the contract was closed out and an equal volume of lumber was sold to Simpson's normal customers at the market price. Id. If commodity price levels had fallen since the date of the original futures contract sale, then there would be a profit from the futures contract. Id. If market prices had risen since the sale of the futures contract, a loss would be recorded when the contract was closed, but the lumber prices received from Simpson's customers would be higher than expected several months earlier. Id. The gains and losses from the futures contracts were accumulated and used to adjust average sales per thousand board feet in quarterly or annual comparisons. (CP 111-12.)

D. Why Review Should Be Refused.

This Court should decline review of this case for any of the following reasons:

1. The Court of Appeals Correctly Applied the Law Governing RCW 82.04.4281, Without Creating Any Conflict With Decisions of This Court. The Court of Appeals correctly applied this Court's decisions in Sellen and Rainier. The Court of

Appeals began its analysis by pointing out that Sellen established the definition of the term "financial business" for purposes of the Section 4281 Deduction, and this means "a business whose primary purpose and objective is to earn income through the utilization of significant cash outlays." Simpson, 92 Wn. App. at 918 (court's emphasis), citing Sellen, 87 Wn.2d at 882. This definition does not describe Simpson's business. "Simpson's primary purpose and objective is to manage its timber industry related subsidiaries." Simpson, 92 Wn.2d at 918-19. Thus, Simpson is not a "financial business" under the clear and unambiguous test established by this Court in Sellen.

The Court of Appeals also correctly applied this Court's decision in Rainier. The Department claims Rainier is controlling because both Rainier and Simpson were parent holding companies receiving some form of investment income. But this is the only similarity between Rainier and Simpson.

In Rainier, this Court found it appropriate to look at the businesses of the subsidiaries to

determine whether some or all of them were engaged in a "financial business." This Court found all of Rainier's subsidiaries to be engaged in financial businesses. Obviously, when a holding company's function is to oversee the business activities of its subsidiaries, and the subsidiaries are all financial businesses, it becomes very difficult for the parent to argue, as Rainier attempted, that it was not engaged in a financial business. Moreover, Rainier, the parent holding company, was itself engaged in making loans to subsidiaries and interest income from those loans amounted to 41.1 percent and 58.1 percent during the two audit periods in question. These two factors were relevant and material to determining whether the parent holding company was engaged in a financial business, and to this Court's ultimate decision to characterize Rainier as a "financial business."

Simpson's situation is the antithesis of Rainier's. Simpson's subsidiaries are not engaged in financial businesses. They grow and harvest timber and manufacture pulp, paper, other wood products and plastic pipe. Simpson does not make

loans to its subsidiaries; it merely receives, as the taxpayers in Sellen received, a small portion (less than five percent) of its income from investment sources: interest on bank deposits, dividends from a portfolio of stock in competitor forest products companies and, for a time, gains from lumber futures trading. The Department's contention that "Simpson does not carry on any trade or business other than managing its investments" (Petition at 8) is simply not true. Simpson is engaged in administering and managing "its timber industry-related subsidiaries" (Simpson, 92 Wn. App. at 919), not in managing investments (which are incidental at most).

2. The Department Ignores the Purpose and Function of Holding Companies. The Department's claim that Simpson nonetheless should be treated as a "financial business" would effectively have required that the Court of Appeals -- and now this Court -- ignore the well established function of parent holding companies. The United States Supreme Court has characterized the dominant feature of a holding company as the ownership of securities to make it possible to control or

substantially influence the policies and management of the operating companies. North American Co. v. Securities & Exchange Commission, 327 U.S. 686, 701, 90 L. Ed. 945, 66 S. Ct. 785 (1946). As a leading treatise writer on the subject observed:

In its essential meaning the holding company, as the name implies, is merely a corporation organized to hold in its treasury the stocks or bonds of other corporations. But the phrase in actual usage is ordinarily confined to the corporation which exercises some measure of administrative control over the corporations the stock of which lie in its treasury. It stands in contrast to the investment company, which embodies little or no direct purpose of control.

2 A. Dewing, The Financial Policy of Corporations, Chapter 6, "The Holding Company," at 1032 (4th ed. 1941) (emphasis added). Plainly, the record establishes that Simpson⁶ is a holding company of

⁶Although Simpson's corporate name includes the words "Investment Company," those words should not be read as descriptive of Simpson's business. The phrase "Investment Company" has historical significance to the Simpson family of companies because it was the name adopted for the first Simpson corporate family holding company in the early twentieth century. R. Spector, Family Trees: Simpson's Centennial Story, at 16 (1990). The "Investment Company" name within the Simpson family of companies thus dates back nearly 100 years. The "Investment Company" name was dropped in the intervening years but "[m]any years later, the . . . family revived the Investment Company name, (continued . . .)

the classic type. If Simpson is to be deemed a "financial business," then any holding company in this state would have to be deemed a financial business. Such a result is not supported either by the language of the Section 4281 Deduction, or this Court's decisions in Sellen and Rainier,⁷ and would also conflict with the Legislature's policy decision to exclude dividends from subsidiaries as taxable income. See RCW 82.04.4281.

3. Simpson's Business Is the Same as Its Subsidiaries. The Department also argues that the Court of Appeals erred because it did not consider Simpson's business separate and apart from the business of its subsidiaries (Petition at 10, 13-14), citing Nordstrom Credit, Inc. v.

(. . . continued)
though its purpose was different." Family Trees, at 31. That "revival" was the organization of Simpson Investment Company as a parent holding company for all of Simpson's timber, lumber, paper, pulp, plastic pipe and other units. Family Trees, at 199 & 206; see (CP 84-88). This point was also clarified at oral argument before the Court of Appeals. See Excerpt from Transcript of Oral Arguments (pages 8-9), copy attached as Ex. B to the Appendix to this Answer.

⁷This Court stated in Rainier that its decision was "limited to holding companies, such as Rainier, which are engaged in a 'financial business.'" Rainier, 96 Wn.2d at 674.

Department of Revenue, 120 Wn.2d 935, 845 P.2d 1331 (1993); Washington Sav-Mor Oil Co. v. State Tax Comm'n, 58 Wn.2d 518, 364 P.2d 440 (1961); American Sign & Indicator Co. v. State, 93 Wn.2d 427, 610 P.2d 353 (1980); and Rena-Ware Distribs., Inc. v. State, 77 Wn.2d 514, 463 P.2d 622 (1970). Yet this Court in Rainier, as well as the Court of Appeals in Simpson, recognized that in the context of the Section 4281 Deduction, it is material to look at the business in which the subsidiaries are engaged. If that were not true, this Court in Rainier would not have discussed the subsidiaries' businesses as part of its analysis. The fact that the Department argues for the tax liability of a holding company like Simpson to be determined without regard to the business of the holding company's subsidiaries merely underscores that the Department seeks to effect a change in state B&O tax law which would disregard the very nature of the parent-subsidary relationship.

4. The Department Seeks Review on Grounds Different From the Positions That the Department Took Before the Court of Appeals. Simpson argued before the Court of Appeals that the Department's

inclusion of dividends from subsidiaries as "investment income" was tantamount to declaring that all holding companies should be treated as financial businesses. See, e.g., Appellant's Opening Brief at 33; Appellant's Reply Brief at 6-7. After denying before the Court of Appeals that it had any intent to make such a claim, the Department has now reversed itself. For the first time the Department acknowledges that a determination that Simpson is a "financial business" would also apply to holding companies generally. Compare Petition at 9, n.3 with Brief of Respondent at 20. Apparently for precisely this reason, the Department now argues that this makes the case worthy of review, because "in the aggregate" there are "substantial amounts of taxes" at stake here. Petition at 9, n.3.⁸

The Department also argued before the Court of Appeals that ETB 571 controls the disposition

⁸The Department did not make this "substantial lost revenue" argument to the Court of Appeals. Whether the Court of Appeals' decision actually would result in a "substantial" revenue loss is, in any case, irrelevant. Only the language of RCW 82.04.4281, and its prior construction and interpretation by this Court, are relevant.

of this case and that Simpson failed both tests set forth in the bulletin. See Brief of Respondent at 26-28. When Simpson challenged the validity of ETB 571 under the Administrative Procedure Act ("APA"),⁹ the Department went so far as to claim that the interpretation of the Section 4281 Deduction set forth in ETB 571 was "entitled to great weight," even if ETB 571 was found to have been adopted in violation of the APA. See Brief of Respondent at 30. Before this Court, however, the Department contends that ETB 571 is, as of July 1, 1998, "advisory only." See Petition at 16, n.6.¹⁰ This position -- that

⁹If this Court accepts review of the case, the briefs frame an important question about the validity of ETB 571. Although the Court of Appeals did not reach the issue, this Court will need to address it.

¹⁰Simultaneous with the Department's July 1, 1998 apparent decision that ETB 571 (and all other ETBs) were "advisory only," the Department made the following announcement:

ETAs [formerly ETBs] are technical "applications" and are advisory to taxpayers. They are written statements of Department positions and explain how statutes or WAC rules apply in unique, special, and complex factual cases or transactions. The Department is bound by an advisory in the same factual situations until court action, legislative action, rule adoption, or an
(continued . . .)

ETB 571 is "advisory only" -- was never presented to the Court of Appeals. Given that the standard of review under RAP 13.4(b)(4) is "substantial public interest," exactly what is the substantial public interest if ETB 571 is merely advisory? In fact, there is no good reason why this Court should be concerned about a purely advisory bulletin -- certainly not as an independent basis for review.

The Department also claims it will have great difficulty administering the exemption after the Court of Appeals' decision. The Department's administration of RCW 82.04.4281 has gone through two phases after Sellen and Rainier. Initially, the question of whether a taxpayer was a financial business was answered by evaluating the overall

(. . . continued)

amendment to the ETA supersedes the advisory. An ETA may be either an interpretive or policy statement as contemplated by RCW 34.05.230, and is intended to advise the public of the Department's current position, interpretation, policy, or approach.

Excise Tax Advisory, copy attached as Ex. C to the Appendix to this Petition (emphasis and bracketed inclusion supplied). In other words, ETB 571 is advisory for taxpayers but mandatory for Department personnel.

business, and the Department did not use any sort of percentage formula (presumably because Sellen and Rainier rejected such an approach). Moreover, the Department specifically addressed the deductibility of interest earned from operating a cash management system identical to the system operated by Simpson. In published Final Determination No. 86-309A, 4 WTD 341 (1987), the Department stated:

The more recent technological advances within the financial and banking industries have made possible the instantaneous electronic movement of funds between related accounts which enables the sophisticated and highly efficient methods of managing business capital to achieve the most beneficial availability and use of such funds. Thus, by various methods of assuring these efficiencies, many vertically integrated business organizations have developed internal control networks for daily money movement between their respective subsidiary and affiliate entities. Such centralized money management techniques generally involve the daily funding of operating subsidiaries by the parent or managing entity and the end of day sweeping of all subsidiary accounts down to a zero or minimum targeted balance. Banks and other financial institutions have developed and marketed such programs which they will manage for a fee.

(CP 242); see also Simpson at 922 (citing and quoting from another portion of 4 WTD 341, in which the Department stated that business entities "do not assume the characteristics or functions of

'financial businesses' . . . merely by virtue of performing internal fiscal functions").

Years later, the Department did an about-face and repudiated its prior interpretations. Although it is unclear why the Department did so, the Department's petition strongly suggests that the reason was to generate more revenue. The Department therefore decided to revisit the issue -- and to do so without any rule-making. The Court of Appeals' decision has done nothing more than to construe ETB 571 consistent with this Court's decisions, and bring the Department's administration of the Section 4281 Deduction back into line with those decisions. Nothing about this result should complicate the administration of Washington tax law, given the Department has only been required to go back to what it did for many years following Sellen and Rainier.

E. Conclusion.

Simpson has long been recognized as a timber and forest products company. See Turning a Titan, Puget Sound Business Journal (June 26-July 2, 1998), copy attached as Ex. D to the Appendix to this Answer. Yet the Department continues to

claim Simpson is a financial business -- equivalent to a bank or finance company -- when Simpson plainly is not. This Court should decline the Department's invitation to create an exception to the well established legal principles previously established by this Court in Sellen and Rainier, and correctly applied by the Court of Appeals in this case when it held that Simpson qualified for the Section 4281 Deduction.

RESPECTFULLY SUBMITTED this 23rd day of March, 1999.

LANE POWELL SPEARS LUBERSKY LLP

By Michael B. King
George C. Mastrodonato
WSBA No. 07483
Michael B. King
WSBA No. 14405
Kathleen D. Benedict
WSBA No. 07763
Attorneys for Respondent
Simpson Investment Company

CERTIFICATE OF SERVICE

I hereby certify that a copy of this document was served via U.S. MAIL AT LAST KNOWN ADDRESS

On: JOHN S. BARNES, REVENUE DIV.
ATTORNEY GENERAL'S OFFICE

Date: MARCH 23, 1999

By: Robert L. Ulan

APPENDIX

- Exhibit A** **Sweep Accounts Simplify Finances, The Olympian, February 2, 1999**
- Exhibit B** **Excerpt of Transcript of Oral Argument, September 1, 1998**
- Exhibit C** **Excise Tax Advisory, Number 2001, July 1, 1999**
- Exhibit D** **Turning a Titan...., Puget Sound Business Journal, June 26-July 2, 1998**



ANN COOKE
THE ABLE INVESTOR

'Sweep' accounts simplify finances

■ **ALL IN ONE:**
A comprehensive
management account
centralizes your finances.

The Social Security Administration strongly encourages all Social Security and Supplemental Security Income (SSI) beneficiaries to receive their monthly benefits by direct deposit.

You can still receive your Social Security benefits by check, but you should consider the many benefits that direct deposit offers.

According to the Social Security Administration, check thefts have doubled during the past 10 years. By contrast, in the 21 years direct deposit has been available to Social Security beneficiaries, not one direct payment has ever been lost.

To facilitate the direct deposit process, consider opening a comprehensive management account, available from most brokerage firms, or a bank "sweep" account. A centralized asset account — a combination checkwriting, credit and/or debit card, money-market fund and brokerage account — is perhaps the single most useful financial tool widely available to investors today. And these accounts do more than just house your cash and investments — they simplify your financial life.

In the late 1970s, centralized accounts are now offered by leading brokerage firms, some banks and a few other financial institutions. They are known by a variety of names, but all operate in essentially the same manner:

The cash in your checkwriting account, as well as temporarily uninvested cash in your brokerage account, is "swept" every day (or every week) into a money-market fund. You can choose from either a general money fund or a government securities fund, and may switch funds whenever you wish.

Beyond these basics, the accounts differ somewhat as to specific features, services, minimum balances and fees. Some offer credit cards, others debit cards. Some have lower minimum balances than others. Some provide itemization of your checks according to expense category (medical, charitable contributions, etc.), which can be a great help for tax preparation. Some even offer preferred lines of credit up to \$100,000.

Easy money access

Think about what can happen if your money is spread among, say, a bank, a credit union, a brokerage firm and a couple of mutual fund companies, and you suddenly want to make a sizable investment in a stock.

To collect the necessary funds to make your investment, you may find yourself making in-person withdrawals, telephone redemptions and mail redemptions. After all this time and inconvenience, your stock may well have moved up sharply. In contrast, if you have a centralized asset account, all your funds are right there, ready to be deployed at a moment's notice.

Centralized accounts provide access to funds in another way, too. By using your checkwriting privileges, credit/debit card or credit line, you can tap into your account to pay bills or come up with cash no matter where you are. Since all these services are linked, you don't have to worry about overdrawing your account or running short of cash.

If you're not sure whether this type of account is right for you, check with a financial consultant at the offering institution. If you'd like to enroll now to receive your Social Security benefits by direct deposit, just call (800) 772-1213

A financial consultant and second vice president at the Olympia branch of Salomon Smith Barney, Ann Cooke manages individual portfolios as well as corporate retirement plans. Your comments, questions, and suggestions for future columns are welcome. Readers may write to her at Salomon Smith Barney, 724 Columbia St. N.W., Suite 350, Olympia, WA 98501, or call (360) 943-2300 or (800) 843-7564.

EXHIBIT A

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

SIMPSON INVESTMENT COMPANY,)

Appellant,)

vs.)

STATE OF WASHINGTON,)
DEPARTMENT OF REVENUE,)

Respondent.)

NO. 96-2-02386-5

APPEALS NO. 22907-2-II

TRANSCRIPT OF ORAL ARGUMENTS

TRANSCRIBED BY: Rough & Associates, Inc./BAS

EXHIBIT B

1 THE COURT: Counsel, in figuring the taxes --
2 whether or not there are deductions allowed -- isn't the focus
3 on the holding -- the parent company -- rather than what all
4 the subsidiaries are doing? They would be looked at
5 separately for B & O tax purposes.

6 MR. MASTRODONATO: Yes, they're looked at separately
7 for B & O tax purposes, but let's look at the purpose and
8 objective of Simpson Investment Company, because that's really
9 what we're focused on.

10 THE COURT: And it's also called -- why is it
11 called Simpson Investment Company? I'm sorry to send another
12 question on top of the other one.

13 MR. MASTRODONATO: Sure. I can deal with your second
14 question, maybe, quicker. That is -- I'm not going to say
15 unfortunate -- but that is a family name. Back in 1895 Sol
16 Simpson, the founder of the Simpson family of companies, named
17 his personal family holding company Simpson Investment Company
18 and it was eventually dropped over the years and then in 1985
19 when Simpson went to that structure -- reactivating a holding
20 company -- they picked up the old family name. And it
21 happened to have the word "investment" in it, but it had
22 nothing to do with -- that they were investing money, that
23 they were taking deposits, that they were a bank, they were a
24 mutual fund. It was just an old family name that they
25 happened to resurrect.

1 But to get to your first question, the people -- the
2 record reflects all of the different operating sections of
3 Simpson Investment company. They have a large human resources
4 department. They have a tax department. They have an in-
5 house legal department. These people aren't taking deposits,
6 loaning money to anybody. They are managing and operating and
7 running the timber, the forest products, and the plastic pipe
8 businesses. So that's what we looked at and, you know, in
9 spite of the name having the word "investment" in it, that
10 exactly fits squarely within the definition of Sellen.

11 THE COURT: So do we look at what the employees of
12 Simpson Investment Company are doing, or do we look at the
13 source of the income that Simpson Investment Company receives?

14 MR. MASTRODONATO: We look at what the employees are
15 doing in Simpson, and that's the Department of Revenue's test.
16 The Department of Revenue has mischaracterized the test in the
17 Sellen case. They are looking only at the source of the
18 revenues and the source of the revenues in any holding company
19 situation is dividends from the subsidiaries. And in 1995,
20 they adopted a new test. Without going through any sort of
21 administrative law, APA -- Administrative Procedures Act --
22 proceeding, they adopted a new test that said if you have more
23 than 5% of your income as financial nature or investment
24 income, you're presumed to be a financial business. Well,
25 that test basically takes every holding company in the State



Excise Tax Advisory

Excise Tax Advisories (ETA) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

NUMBER: 2001

ISSUE DATE: July 1, 1998

NUMBERING AND USE OF EXCISE TAX ADVISORIES

This ETA explains the purpose of the Excise Tax Advisories (ETAs), the numbering system used on ETAs, and conditions under which ETAs are issued.

NUMBERING SYSTEM:

ETAs issued in the future will be issued a four-digit number beginning with the number "2". For example, ETA 2001 is a new advisory. The numbering system is similar to that previously used for Excise Tax Bulletins. These four-digit numbers will be issued in sequential order.

The remaining Excise Tax Bulletins (ETBs) have been canceled and reissued as Excise Tax Advisories. These converted ETBs, which are now ETAs, show a conversion date as well as the original issuing date and retain the same number that they had as ETBs.

An ETA will normally have a nine-digit number separated by decimals. The first, three- or four-digit number represents the chronological order in which the document was issued. The second, two-digit number refers to the chapter number of Title 82 RCW which is the subject of the document. If the ETA has one, the final three-digit number represents the Department's administrative rule relating to the subject of the advisory. Agency rules are published in the Washington Administrative Code (WAC). The Department of Revenue's general excise tax rules are found in chapter 458-20. Thus, WAC 458-20-111 ADVANCES AND REIMBURSEMENTS is the Department's excise tax rule dealing with the subject of advances and reimbursements.

ETBs have been made Excise Tax Advisories, and have retained their old number. Advisories with a 2 (plus three digits) are new advisories, ETBs that have been revised and readopted after review under the Department's regulatory improvement program, or advisories that have been revised and/or readopted.

Please direct comments to:
Department of Revenue
Legislation & Policy Division
P O Box 47467
Olympia, Washington 98504-7467
(360) 753-4161 eta@DOR.wa.gov

To inquire about the availability of receiving this document in an alternate format for the visually impaired or language other than English, please call (360)753-3217. Teletype (TTY) users please call 1-800-451-7985.

ETA 530.04.111 would represent the following:

ETA 530 -- the 530th excise tax advisory (formerly bulletin) issued
.04. -- the advisory addresses B&O tax, found in chapter
82.04 RCW
.111 -- the advisory involves Rule 111.

In citing an ETA, it is enough to refer simply to the first unit of the number (e.g., ETA 530 or ETA 2001), since this fully identifies a particular bulletin. The remaining numbers are merely descriptive of the subject or content.

Some ETAs refer to the "Tax Commission". The Tax Commission was replaced in 1967 with the Department of Revenue, which assumed the same duties and responsibilities. References within ETAs to the Tax Commission should be treated as if the reference were to the Department of Revenue.

PURPOSE:

ETAs are technical "applications" and are advisory to taxpayers. They are written statements of Department positions and explain how statutes or WAC rules apply in unique, special, and complex factual cases or transactions. The Department is bound by an advisory in the same factual situations until court action, legislative action, rule adoption, or an amendment to the ETA supersedes the advisory. An ETA may be either an interpretive or policy statement as contemplated by RCW 34.05.230, and is intended to advise the public of the Department's current position, interpretation, policy, or approach.

There may be some delay between the time of a law change and the time an ETA is revised. For this reason users, of ETAs are cautioned, when applying a particular ETA, to make certain the principles contained in the advisory have not been superseded by subsequent court, legislative or administrative action.



Excise Tax Advisories Are Replacing Excise Tax Bulletins and Revenue Policy Memoranda

Excise Tax Bulletins (ETBs) have been used by the Department of Revenue since 1966, when the Department converted Tax Commission rulings into ETBs. Revenue Policy Memoranda were issued in 1989, 1990 and 1991 as policy statements under RCW 34.05.230. The purpose of both types of documents was to provide a vehicle for quickly advising the taxpaying public of changes to tax applications or changes in the Department's positions due to court rulings, legislative changes, and business changes.

To consolidate all excise-tax related interpretive or policy statements into a single series, and to clearly indicate to all readers that these documents are advisory only, the Department has reissued the existing ETBs and RPMs as Excise Tax Advisories (ETAs). The Department will continue reviewing the documents and canceling those which are unnecessary, and incorporating others into rules as appropriate. New interpretive or policy statements relating to excise tax will be issued as Excise Tax Advisories.

ETAs issued in the future will have a four-digit number beginning with "2". Existing ETBs which have been "converted" to ETAs retain the same three-digit number that they had as ETBs. Existing RPMs also have been converted and retain the same date/year numbering system. Please see ETA 2001 for a more complex explanation of the numbering system.

During the review process under Executive Order 97-02, the Department is discovering that many ETBs could be included in a rule. Until the actual rule amendment takes place the ETA will remain to provide information to taxpayers and the Department.

As required by RCW 34.05.230 (4), a listing of the repealed ETBs and this explanation of the adoption of the new ETA series will be forwarded to the Office of the Code Reviser for publication in the Washington State Register.

Please direct any comments to the: Department of Revenue
Legislation and Policy Division
P O Box 47467
Olympia, Washington 98504-7467



STATE OF WASHINGTON

DEPARTMENT OF REVENUE

P.O. Box 47450 • Olympia, Washington 98504-7450 • (360) 786-6100 • FAX (360) 586-5543
INTERNET ADDRESS: <http://www.wa.gov/dor/wador.htm>

July 1, 1998

Dear Rules List Subscriber:

Excise Tax Advisories Are Replacing Excise Tax Bulletins and Revenue Policy Memoranda.

Excise Tax Bulletins (ETBs) have been used by the Department of Revenue since 1966, when the Department converted Tax Commission rulings into ETBs. Revenue Policy Memoranda were issued in 1989, 1990 and 1991 as policy statements under RCW 34.05.230. The purpose of both types of documents was to provide a vehicle for quickly advising the taxpaying public of changes to tax applications or changes in the Department's positions due to court rulings, legislative changes, and business changes.

To consolidate all excise-tax related interpretive or policy statements into a single series, and to clearly indicate to all readers that these documents are advisory only, the Department has reissued the existing ETBs and RPMs as Excise Tax Advisories (ETAs). The Department will continue reviewing the documents and canceling those which are unnecessary, and incorporating others into rules as appropriate. New interpretive or policy statements relating to excise tax will be issued as Excise Tax Advisories.

ETAs issued in the future will have a four-digit number beginning with "2". Existing ETBs which have been "converted" to ETAs retain the same three-digit number that they had as ETBs. Existing RPMs also have been converted and retain the same date/year numbering system. Please see ETA 2001 for a more complex explanation of the numbering system.

During the review process under Executive Order 97-02, the Department is discovering that many ETBs could be included in a rule. Until the actual rule amendment takes place the ETA will remain to provide information to taxpayers and the Department.

CODE REVISER'S OFFICE STATE OF WASHINGTON FILED	
JUL 7 1998	
TIME	4:33
WSR	98-15-034
	AM PM

Legislation & Policy Division

PO Box 47467 ♦ Olympia, Washington 98504-7467 ♦ Phone (360) 753-1063 ♦ Fax (360) 664-0693



July 1, 1998

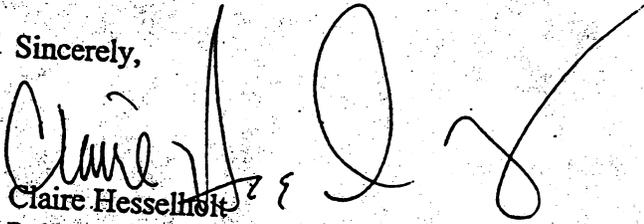
As required by RCW 34.05.230 (4), a listing of the repealed ETBs and this explanation of the adoption of the new ETA series will be forwarded to the Office of the Code Reviser for publication in the Washington State Register.

Please direct any comments to the: Department of Revenue
Legislation and Policy Division
P O Box 47467
Olympia, Washington 98504-7467

Or telephone (360) 753-4161

Email eta@DOR.wa.gov FAX (360) 664-0693

Sincerely,



Claire Hesselroth
Policy Counsel/Rules Manager

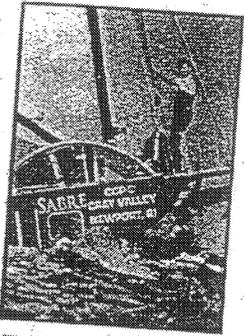
PUGET SOUND Business Journal

JUNE 26-JULY 2, 1998

VOL. 19 NO. 7

 CAR-RT SORT ** C076
 018284
 02 DC
 LIBRARY
 LANE POWELL SPEARS LUBERSKY
 2120 CATON WAY SM STE B
 LIBRARY
 OLYMPIA WA 98502

INSIDE



RJR overboard
 Sailing race rejects tobacco's sponsorship
Page 3



Hot wheels
 Small Business Weekly
Pages 16-20



it in the

TURNING A TITAN

Simpson Investment, the state's largest private company, is in the midst of a monumental makeover

STORY, PAGE 25

Washington's Largest 100 Private Companies

List and profiles, pages 25-64



Simpson Investment CEO Colin Moseley

BUSINESS JOURNAL PHOTO/RICK DAHMS



New \$50M vent draws Schultz's

By RAMI GRUNBAUM
 MANAGING EDITOR

With \$50 million in capital and the personal backing of Starbucks Coffee Co. chairman Howard Schultz, a new Seattle investment fund hopes to help some other consumer brands become as ubiquitous as the java pioneer.

money manager to raise up to handful of instit Levitan said everything from pants to food and electronic

Maveron LLC

CHARTING A NEW COURSE

By GEORGE ERB
STAFF WRITER

Like the wiry pioneer who is the company's namesake, the Simpson Investment Co. of Seattle is responding to a tough business climate by reinventing itself.

When Sol G. Simpson lost his house in a Nevada mining town in 1878, he moved his family to Seattle and found work driving horses for the crews that were building the city's streets and railroads.

Simpson, a thin man with a big mustache, later moved to Mason County, where he prospered by using horses to build roads and haul logs. In 1890 he started his own company, the S.G. Simpson Co.

More than a century later, Sol Simpson's start-up has become Simpson Investment, a holding company that owns about 792,000 acres of domestic timberland and more than a dozen mills.

And the private company, like its founder 120 years ago, is in the middle of a monumental remake.

Simpson Investment is shedding most of its paper and packaging mills and concentrating mostly on growing trees, making lumber and manufacturing related wood products.

The transformation has been painful. Since 1995, the company has either sold or closed six mills. Another four mills are still on the block, although a deal for one of them is on the verge of closing.

At one point the company employed as many as 8,500 people; now Simpson Investment has 4,200 on the payroll.

"It's been a tough couple of years, and it's affected a lot of people," said Colin Moseley, chairman of Simpson Investment. "We've had to say goodbye to a lot of folks; it's been a difficult thing to do."

The pivotal year for Simpson Investment was 1995, when executives realized that the company needed to change because of tough times in the pulp-and-paper industry.

For nearly 40 years, beginning in 1951, the company had branched out by buying pulp and paper mills nationwide. Simpson Investment was especially busy in the 1980s, snapping up six mills in 10 years.

Then, in the early 1990s, the pulp-and-paper business sickened.

Companies, spurred on by steady growth and strong prices for its products in the 1980s, spent billions of dollars either building new mills or expanding old ones.

But the industry expanded too quickly, glutting the market. An economic slowdown only worsened market conditions.

Prices for most grades of pulp and paper fell.

See REMAKE, Page 26

Simpson Investment is undergoing a monumental remake due to the declining pulp-and-paper industry



BUSINESS JOURNAL PHOTO/TRICK DAHMS

CEO Colin Moseley has overseen the massive transformation of Simpson Investment from a primarily pulp-and-paper firm to a timber company.

INDEX

Two words — tomorrow and yesterday — define the success of Ben Bridge Jewelers — page 27.

Companies on different continents have helped Marine Construction and Design remain afloat — page 30.

Undaunted by a decline in younger readers, *The Seattle Times* remains committed to the newspaper industry — page 32.

There's already a hamburger for adults. Now Tree Top has introduced an apple juice for the mature palate — page 44.

Casual is out, elegance is in, and that means good times ahead for the Seattle Fur Exchange — page 46.

Bucolic existence suits Wilcox Family Farms just fine — page 50.

Rabanco, the area's largest waste-disposal firm, has been sold to an out-of-state company, but its local presence won't be discarded — page 58.

Hi-School Pharmacy outgrows its small-town drugstore roots — page 64.

And Wilder Construction Company is determined to prove it.

We've joined with Western Washington University to create a unique professorship where, beginning in the fall of 1998, graduate students will be able to earn interdisciplinary degrees in business and environmental studies.

The Wilder Construction Company Distinguished Professorship of Business and the Environment will be funded by matching \$250,000 grants from Wilder and the state's Distinguished Professorship program.

Building an environmentally sound future will take teamwork. Wilder and WWU are up to the challenge.

WILDER
WILDER CONSTRUCTION COMPANY

Environmental Capabilities:

- On-site Treatment
- Landfill/Gap Construction
- Contaminated Material Handling
- Facility Decontamination
- Impaired Property Restoration
- Environmental Remediation

1525 E. Marine View Drive
Everett, WA 98201
Phone (206) 551-3173
FAX (206) 551-3116

REMAKE: Simpson takes a different tack

FROM PAGE 25

In a business where a single paper-making machine can cost more than \$300 million, mills must run at close to capacity just to break even. When orders declined and production slowed, some mills started running in the red.

In 1995, the pulp-and-paper industry rebounded for nine months before slipping back into the doldrums. As recently as this month, prices for many grades of pulp and paper were near the bottom of their range.

In Seattle, executives at Simpson Investment watched the unfolding business climate and were sobered by what they saw.

The company's eight paper mills had more competitors than ever before. Some overseas mills were getting government subsidies and hiring less expensive workers. The newer mills also were more efficient than Simpson Investment's older mills.

The company could make its paper mills more competitive, but the project could cost hundreds of millions of dollars. And the pulp-and-paper business wasn't showing any sign of a turnaround.

"We concluded that we couldn't wait any longer," Moseley said. "The capital needed to stay in the game was too high a bet to make."

So the company decided to sell most of its pulp and paper mills, with one notable exception. Simpson Investment will keep the Simpson Tacoma Kraft Co., which makes pulp and packaging material.

Other companies have come to similar conclusions. The pulp-and-paper industry is now in a period of consolidation, in which companies merge, sell off their mills or buy up a competitor's mills, analysts say.

At Simpson Investment, executives decided to concentrate on the company's timberlands in Washington, Oregon and Northern California. The private forests are productive, and the company has worked hard to meet environmental regulations.

The company also is trying to add to its timberland holdings. Last month, Simpson Investment agreed to buy 74,000 acres of timberland in Northern California from the Louisiana-Pacific Corp.

The Louisiana-Pacific property, located between two large tracts of Simpson timberland, has been a regular on Simpson's wish list. Moseley says the company wants to complete the deal.

"It's been on our list of the 10 most desirable properties for years," he said.

Simpson Investment also decided to keep its sawmills, a plywood mill and other remanufacturing facilities. The company can saw its own logs or buy logs from outside suppliers.

Simpson Investment kept the Tacoma kraft mill because of its stronger market position and efficiency. The company has invested millions in the mill in recent years, including as much as \$60 million on a recycling plant.

The end of the company's painful transformation may be in sight.

By August 1, Simpson Investment will move its headquarters, with its smaller corporate staff, out of the Washington Mutual Tower on Third Avenue in Seattle to the Rainier Tower on Fifth Avenue.

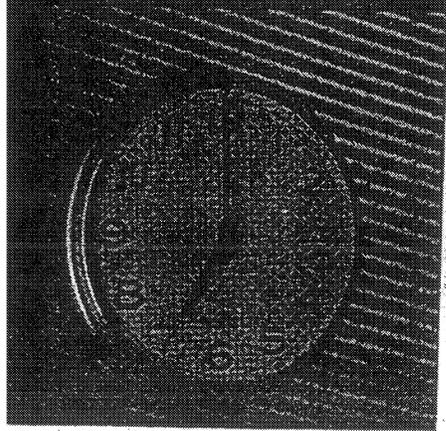
The company also wants to complete the sale of four paper mills in California, Iowa and Texas by the end of the year, Moseley said. In fact, a closing may be imminent on the San Gabriel Mill in Pomoña, Calif.

Once the remaining mills are sold, Simpson Investment's employment will drop to about 2,700.

More and more, Simpson Investment is looking like the company that its executives want it to be five years from now — a timber company with some sawmills and little presence in the pulp-and-paper industry.

"The company has been through tough times like this before," Moseley said. "This will just be another chapter."

o you know where Your ISP is?



NO SQUARE PEGS

APPENDIX E



STATE OF WASHINGTON
DEPARTMENT OF REVENUE
Olympia, Washington 98504-0090 MS-AX-02

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition
For Correction of Assessment of

F I N A L
D E T E R M I N A T I O N

No. 86-309A

Registration No. . . .

[1] RULE 109, RCW 82.04.080, RCW 82.04.220: B&O TAX -- GROSS INCOME--
BUSINESS ACTIVITY -- VALUE PROCEEDING OR ACCRUING -- INTEREST -- USE
OF MONEY -- MONEY MANAGEMENT -- FINANCIAL BUSINESS. Cost control
accounting by a parent corporation which reflects "interest" accruals
related to internal, centralized money management systems through
which money is routinely transferred back and forth between the
parent and its wholly owned subsidiary corporations does not result
in value proceeding or accruing to the parent where the booked
"interest" is not paid and is not an enforceable obligation.
Centralized money management between parent and subsidiary companies
does not constitute financial business which derives taxable gross
receipts.

[2] RULE 109 AND RCW 82.04.4281: B&O TAX -- EXEMPTION -- "FINANCIAL
BUSINESS" -- USE OF MONEY AS SUCH. The centralized management of
corporate funds between a parent corporation and its wholly owned
subsidiary companies constitutes the "use of money as such" by a
person not otherwise engaged in a "financial business." Booked
amounts which represent interest expense connected with such
established money management activities, when paid, are exempt of b&o
tax.

TAXPAYER REPRESENTED BY: . . .
. . .
. . .

HEARING CONDUCTED BY DIRECTOR'S DESIGNEES:
Sandi Swarthout, Assistant Director
Garry G. Fujita, Assistant Director
Edward L. Faker, Sr. Administrative Law Judge

DATE AND PLACE OF HEARING: April 29, 1987, Olympia, Washington

NATURE OF ACTION:

The taxpayer appeals from the findings and conclusions of Determination No. 86-309 which was issued on December 5, 1986, following an original hearing conducted on August 15, 1986. That Determination sustained the assessment of business and occupation tax under the Service classification measured by amounts entered on the taxpayer's books of account and designated as "interest," derived from providing daily operating funds to the taxpayer's wholly owned subsidiary companies.

FACTS AND ISSUES:

Faker, Sr. A.L.J. -- The facts of this case are not in dispute. They, together with the audit and tax assessment details of the case, are fully and properly reported in Determination 86-309 and are not restated herein. The operative facts are included below only as necessary to explain the taxpayer's testimony and arguments and to circumscribe the ruling in this Final Determination.

There is a single, complex issue for our resolution. Are amounts which the taxpayer, parent company, enters upon its books as "interest," and which are calculated upon daily advances or disbursements of operating funds to the accounts of wholly owned subsidiary companies, subject to business and occupation tax? Conversely, are such amounts exempt of b&o tax under the provisions of RCW 82.04.4281 as amounts derived from investments or the use of money as such by qualifying persons?

TAXPAYER'S EXCEPTIONS:

The taxpayer asserts that it received no actual payments of interest from its subsidiary companies, nor was any such interest actually earned. Rather, interest calculations were made and entered on the taxpayer's books of account merely as an internal cost accounting control, for use as a measuring method to determine the efficiency of its subsidiary companies' use of operating funds. The taxpayer argues that the Department's assessment of tax resulted from imputing interest income to the taxpayer which was neither earned nor received. It cites the Washington Supreme Court decision in Weyerhaeuser Co. v. Revenue, 106 Wn.2d 557 (1986), for the proposition that the state may not tax "imputed interest."

Alternatively, and more aggressively asserted, the taxpayer argues that its system of internal corporate money management does not result in the occurrence of any taxable event. The taxpayer relies upon the provisions of WAC 458-20-197 (Rule 197) which, the taxpayer argues, provides that there must be the actual receipt of some value (interest) or the legal entitlement to receive some value in the amount of consideration agreed upon, before a taxable event occurs. In this case, the taxpayer asserts, it is not entitled to receive any interest payment nor has it agreed with its subsidiary companies for the payment of any consideration by them in respect to the internal money management system by which the taxpayer centrally provides operating funds and centrally collects operating income from its subsidiaries on a daily basis. This system is accomplished through a network of banking accounts through which

the taxpayer clean-sweeps all subsidiary accounts for the sole purpose of fiscal efficiency and to assure that its own funding is available when and where it is most efficiently useful for purchasing, investment, or other business reasons. No actual loans are transacted; no notes or other evidences of any indebtedness are executed; no interest obligations or rates are agreed upon or secured; and no legally enforceable relationship is created between the taxpayer and its wholly owned subsidiaries. Rather, the taxpayer merely manages the flow of corporate funds and maintains cost control records to determine how efficiently the family of corporate entities is operating. The internal, "interest" account is simply useful to determine the fiscal viability of subsidiary companies and to measure internal efficiencies of scale so that year-end bonuses to subsidiaries, etc., may be determined and calculated.

The taxpayer stresses that it is not primarily engaged in any "financial business" merely because it performs the corporate money management functions of its own businesses. It does not offer money management services to any others and is not licensed, organized, or equipped to do so. It is not regularly engaged in making financial transactions or performing financial services for anyone, including its own subsidiaries. The taxpayer cites the decision in Sellen Construction Co. v. Revenue, 87 Wn.2d 878 (1976) for its position that it is not a "financial business" nor is it engaged in any "financial business" activity which is taxable. Thus, the taxpayer asserts, it needs no express statutory deduction or exemption upon which to rely for excluding imputed amounts falsely attributed to activities which do not constitute taxable business activities in the first place.

Moreover, if the Department rules that the "interest" calculations entered on its books for internal cost control purposes actually constitutes income from using its money, the taxpayer claims entitlement to the tax exemption of RCW 82.04.4281. The Sellen case, supra, is again cited as supporting the exempt status of persons in such cases. The taxpayer also relies upon the decision of the Thurston County Superior Court (unappealed) in Howard S. Wright Construction Company and Schucart Industrial Contractors, Inc. v. Revenue, No. 79-2-01310-0 (May 21, 1981). This case, dealing with periodic loans to affiliate companies is referenced as being particularly relevant. Just as in this cited case, the taxpayer stresses that the booked interest attributable to advances or "floats" provided to its subsidiaries averaged only 2.3% of its gross receipts from all business activities over the four year audit period. Also, the source of the funding made available to subsidiaries was the taxpayer's own surplus operating capital and the sale of common stock and convertible bonds.

The taxpayer distinguishes its situation from that reported in Rainier Bancorporation v. Revenue, 96 Wn.2d 669 (1982), which was relied upon, in part, by the Department in sustaining the tax. The taxpayer notes that in the Rainier Banc. case the funds loaned to affiliates were borrowed from outside sources, the interest income amounted to a substantial portion of gross income (41% to 58%), and that taxpayer was a bank holding company (an obvious financial entity) with no operating divisions. The taxpayer stresses that it is primarily if not exclusively engaged in research, development, and manufacturing of aerospace and telecommunication products, not "financial

businesses."

DISCUSSION:

The Department presently has under consideration several appeals of tax assessments involving corporate money management arrangements similar in nature to the taxpayer's in this case. Thus, some background discussion is appropriate for proper perspective. The more recent technological advances within the financial and banking industries have made possible the instantaneous electronic movement of funds between related accounts which enables the sophisticated and highly efficient methods of managing business capital to achieve the most beneficial availability and use of such funds. Thus, by various methods of assuring these efficiencies, many vertically integrated business organizations have developed internal control networks for daily money movement between their respective subsidiary and affiliate entities. Such centralized money management techniques generally involve the daily funding of operating subsidiaries by the parent or managing entity and the end of day sweeping of all subsidiary accounts down to a zero or minimum targeted balance. Banks and other financial institutions have developed and marketed such programs which they will manage for a fee. Banking officials have testified before the Department that these money management systems, even when internally managed by the businesses themselves, are not in competition with banks but are in cooperation with banks. The systems are driven by their own business dynamics rather than by the traditional concept of investing funds for a direct anticipated yield. Yet, traditional cost accounting methods are still employed in connection with these money management systems. Thus, the daily transactions are characterized with the features of loans from the parent or central account to the subsidiary accounts, even to the extent that interest is computed and booked on the records of the parent or central account. This, we are advised, accomplishes a true efficiency measurement of the use of all operating funds. In short, interest expense is computed to derive a true picture of how profitably any operating subsidiary has performed. It tells the business managers what the daily profit/loss status of all funded subsidiary or affiliate entities would be if they were required to procure funding at arm's length in the financial marketplace, and pay a cost for such operating funds. However, we are also advised that no such cost of money is actually charged or paid. Rather, interest costs are imputed, at best. They are neither required to be recorded on the books of account of the parent or managing entity, nor to be reported as actual income for any purpose. The interest computations are exclusively performed for internal, informational, control purposes.

In respect to other appeal cases pending, the Department has reviewed money management service programs of this kind packaged and sold by banks which have appeared and testified in an amicus capacity. Though they are modified to meet the needs of different customers, these programs are identical in purpose and effect with the system explained by the taxpayer in the case before us here. All appellants in these cases have asserted that these money management systems serve to stimulate the state's economy. From a tax policy administration standpoint, they assert, the correct recognition by the Department that these electronic and internal accounting devices do not constitute loans or actual interest income producing transactions will enhance the business climate in

this state and further encourage business sitings here. In fact, two of the persons seeking our ruling on this same question are businesses which have not yet entered this state with their money management functions, pending the outcome of this inquiry.

[1] Turning to the case before us here, we have thoroughly reviewed the taxpayer's pertinent records and its system of internal money management. We have also thoroughly researched the case law cited in support of the taxpayer's positions. Though no case cited was precisely on point, the rationale of the courts is insightful and guiding in our deliberations. Most specifically, the decision in Wright/Schucart, supra, is distinguishable because it concerned outright loans to subsidiary companies which bore actual principal repayment and interest obligations, evidenced by executed loan documents. Moreover, as explained in Determination 86-309, the primary source of funds loaned to affiliates in Wright/Schucart was third party banks rather than operating fund surpluses. The Weyerhaeuser, supra, case involved interest imputed from conditional sales contracts for standing timber sales rather than loans or advances of operating funds to subsidiaries. The Sellen Construction, supra, case involved no loans or funding advances, but dealt only with the passive investments of surplus funds in traditional income producing markets (stocks, bonds, money market accounts, etc.). The very limited ruling in Rainier Bancorporation, supra, concerned only a holding company of institutions which were clearly "financial businesses" by definition. All of these cases are distinguishable. Whether the distinctions are of substantive meaning or are merely factual is a moot question. Nonetheless, none of these cases is dispositive of the question before us here. Instead, the issue turns upon the direct statements of statutory law and the tax policy inherent in the administration of those statutory prescriptions.

RCW 82.04.140 defines the term "business" to include:

. . . all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.

Under this definition, money management functions clearly constitute "business."

RCW 82.04.150 defines "engaging in business" in the simplest manner as ". . . commencing, conducting, or continuing in business and also the exercise of corporate or franchise powers"

Clearly, the taxpayer engages in business and exercises corporate powers when it manages corporate funds.

RCW 82.04.030 defines the terms "person" and "company" to be used interchangeably, and to mean,

. . . any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm copartnership, joint venture, club, company, joint stock company, business trust,

municipal corporation, political subdivision of the state of Washington, corporation, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof.

Neither the taxpayer in this case nor any of those in the other cases of this kind on appeal before the Department, argues that the subsidiaries are not separate persons or seeks to have us disregard their corporate separateness.

RCW 82.04.080 defines "gross income of the business" as,

. . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses. (Emphasis supplied.)

Within the scope and intent of the foregoing statutory definitions, it is clear that a "person" may engage in "business" without any "value proceeding or accruing" by reason of the "transaction" of that business.

RCW 82.04.220 imposes the business and occupation tax as follows:

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

Thus, business and occupation tax is only imposed when the transaction of business activities results in gross income--i.e., values proceeding or accruing.

In its administration of these statutes the Department of Revenue recognizes, as a matter of both statutory construction and tax policy, that much business is transacted without incurring business tax liability. In such cases it is not necessary to apply statutory tax exemptions because the activity derives no income to tax. Many integral business activities necessary to the on-going functioning of a business enterprise are routinely performed by the business entity itself, without incurring tax liability, even though these same activities would incur tax liability when procured and paid for in the competitive marketplace. The meaningful question is, then, does the taxpayer's activity of marshalling the profits and losses incurred by its subsidiaries, through the application of internal money management techniques, derive additional, taxable value proceeding or accruing? In our view it does not, for

two distinct and independently dispositive reasons.

First, the money management techniques do not result in any actual payments or receipts to the taxpayer. In its simplest sense, these activities merely result in moving already taxed money from one pocket to another. No fee is charged and no consideration or value is actually received for this function. The cost accounting control achieved by computing the expense of this money movement, designated as "interest" or by any other name, is simply a bookkeeping device. As in the case before us here, there is no evidence of any payment or legally enforceable obligation to pay the computed interest expense. Thus, as a finding of fact, the taxpayer has not received interest income from these money management activities. The court's general rationale in Weyerhaeuser, supra, supports this position.

[2] Second, even if, arguendo, the expense of money management computed and designated as "interest" were deemed to result in value proceeding or accruing to the taxpayer, the specific tax exemption of RCW 82.04.4281 would apply.

The exemption statute provides in pertinent part as follows:

. . . In computing tax there may be deducted from the measure of tax amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such . . .

Under this statute there are two criteria for exemption. (a) The amounts must be derived from "investments or the use of money as such," and (b) the recipient of such amounts must not be a "financial business." Both criteria are satisfied in this case. Our analysis of the money management technique employed by the taxpayer and explained earlier herein reveals that it is simply the "use of money as such." It does not constitute the making of loans or other investments in any traditional sense, nor is it supported by any of the legal evidences of rights and obligations flowing between the taxpayer and its subsidiaries. Rather, it is precisely the kind of marshalling of assets which is contemplated by the statutory language, "use of money as such."

Moreover, business entities do not assume the characteristics or functions of "financial businesses" comparable to banks, loan companies, or investment companies, merely by virtue of performing internal fiscal functions. All businesses perform fiscal functions. All businesses assumably arrange and marshall their own financial affairs in such a manner as to achieve maximum cost and funding efficiencies. The degree of sophistication of such money management enabled by electronic banking technologies does not dictate tax liability under Washington State laws. Performing such functions for one's self neither constitutes engaging in "financial business," nor makes the performing entity a "financial business" by nature. Rather, it is an internalized, incidental function of any business enterprise and is not the taxable business activity in which it is primarily engaged. This is the cumulative rationale of the courts' decisions in the Sellen and Wright/Schucart cases, supra, even though those decisions are not precisely on point with the taxpayer's case here.

Finally, we recognize that identifying the features of money management activities to distinguish them from taxable financial business transactions is difficult at best. The accounting principles employed and records entries made can be unintentionally deceptive. Furthermore, we do not possess the technical expertise to clearly define all of the characteristics of money management methods, especially in a rapidly changing area of electronic technological evolution. In other cases pending appeal before the Department sample programs developed by banks have been submitted for our examination. These programs are now matters of public domain. The basic features and purposes of one such program have been selected and attached to this Final Determination as Exhibit A.¹ Clearly, and unarguably, when programs such as these are marketed or their functions are performed for a fee or charge, that income is taxable under the Service b&o tax classification. This is true even when the business organization itself performs these activities for its subsidiaries if a charge for that service is made. Moreover, our ruling in this case is limited and must be applied only for money management activities as opposed to other arm's length financial dealings between closely related but separate business persons. The latter activities which generate "gross income" are taxable just as if no close relationship existed between the persons. The Department's position with respect to amounts derived from outright, interest bearing loans between parent and subsidiary companies and other financial transactions from which value proceeds or accrues to a taxpayer remains unchanged. See ETB 505.04.109.

DECISION AND DISPOSITION:

The taxpayer's petition is sustained. Tax Assessment No. . . . will be amended to delete Service business and occupation tax on "interest" accruals contained in Schedule II of the audit. The balance of the assessment, if any, will be due for payment in full on the due date to be shown on the amended assessment.

DATED this 16th day of December 1987.

Attachment

¹ Though we have procured permission to reprint excerpts of this program in this Final Determination, all references to its source have been deleted.

AUTOMATED TARGET BALANCE SYSTEM

What Is It?

The Automated Target Balance System is an efficient, economical, and safe method for moving money among a company's [REDACTED] accounts.

A Parent-Subsidiary relationship is established between two or more business checking accounts. The company's funds are kept in the parent account. The other accounts, which we call subsidiary accounts, are opened on a determined target balance. The target may be zero, or any other positive peg on which the customer and Bank agree. The subsidiary account maintains this balance from day to day.

How Does It Work?

At the end of each day, the computer processes the checks presented for payment and deposits for the subsidiary accounts, and calculates the balance. If it is above or below the target, the parent is automatically alerted. By paperless entry, the appropriate transfer between the parent and subsidiary accounts is automatically triggered to bring the subsidiary's balance to its target.

The Daily Parent-Subsidiary Cash Flow Summary is automatically generated and is available at the branch the next day. This report shows the current balances and all transfer amounts of total relationship.

At month-end, the bank statements for each of the subsidiary accounts will show a daily ending balance of the set target, but all transaction detail will be furnished for the company's accounting purposes. The statement for the parent account shows all activity including the transfer amounts.

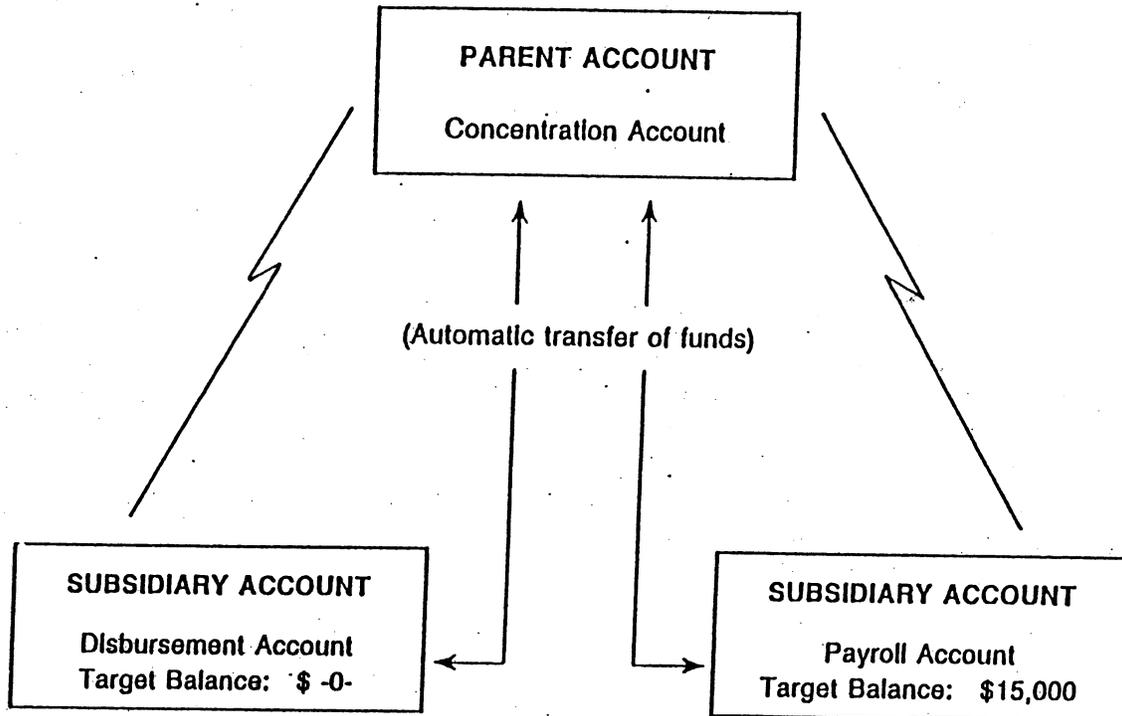
The prime users of this service are companies which have several locations operating out of different accounts, but funded from one central account. Or a company which for accounting reasons has separate accounts for disbursements, payroll, etc., but would like to have all residual funds in one main account.

What Are The Benefits Of This System?

- ▶ Reconciliation is easier and faster.
- ▶ Facilitates evaluation of a company's cash position and maximizes investment opportunities.
- ▶ Transfer amounts are generated automatically to subsidiary accounts, reducing phone calls as well as manual errors.
- ▶ Aids in forecasting check clearing time.
- ▶ Eliminates overdrafts in the subsidiary accounts occurring from incorrect float calculations.
- ▶ Daily summary is provided highlighting the transfer amounts.

AUTOMATED TARGET BALANCE SYSTEM

(Computer automatically alerts parent of the subsidiary's activity.)



- ▶ Checks are debited to subsidiary account.
- ▶ Deposits are credited to the account.
- ▶ Daily balance is determined.
- ▶ If balance is below target balance, the amount of funds that will bring the balance to target is debited to parent account and credited to subsidiary account.
- ▶ If balance is above target balance, the amount of funds that will bring the balance to target is credited to the parent account and debited to the subsidiary account.

No. 65113-7-I

**COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON**

GETTY IMAGES (SEATTLE), INC.,

Appellant,

v.

**CITY OF SEATTLE, DIRECTOR OF THE
DEPARTMENT OF EXECUTIVE AFFAIRS,
DIVISION OF REVENUE AND CONSUMER
AFFAIRS, and CITY OF SEATTLE, OFFICE OF THE
HEARING EXAMINER,**

Respondent.

CERTIFICATE OF SERVICE

Gregg D. Barton, WSBA No. 17022
Stephanie J. Boehl, WSBA No. 39501
PERKINS COIE LLP
1201 Third Avenue, Suite 4800
Seattle, WA 98101-3099
Telephone: 206.359.8000
Facsimile: 206.359.9000

Attorneys for Appellant

I declare that I am employed by Perkins Coie in the County of King, Seattle, Washington, am over the age of 18 years and not a party to the within action; and my address is 1201 Third Avenue, Suite 4800, Seattle, Washington 98101.

On this date, I caused a copy of the Brief of Appellant to be served upon the following via legal messenger:

Kent C. Meyer
Assistant City Attorney
City of Seattle
600 Fourth Avenue, 4th Floor
Seattle, Washington

I further declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 9th day of July, 2010.


Jessica Flesner

FILED
COURT OF APPEALS DIV. #1
STATE OF WASHINGTON
2010 JUL -9 PM 1:49